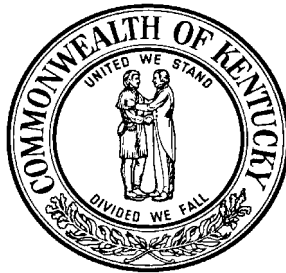


**REPORT OF THE STATEWIDE SINGLE AUDIT  
OF THE  
COMMONWEALTH OF KENTUCKY  
FOR THE YEAR ENDED JUNE 30, 2002**



**EDWARD B. HATCHETT, JR.  
AUDITOR OF PUBLIC ACCOUNTS  
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## EXECUTIVE SUMMARY

### The Statewide Single Audit of the Commonwealth of Kentucky For the Year Ended June 30, 2002

**BACKGROUND:** The Single Audit Act of 1984, subsequent amendments, and corresponding regulations, require the auditing of financial statements and the compliance and internal controls applicable to federal moneys received by the Commonwealth.

**EXPENDITURES:** State organizations expended federal awards in the following manner:

- \$5,567,277,900 in cash from 22 federal grantors
- \$ 634,285,409 in noncash grants (i.e., food stamps)

### SUMMARY OF AUDITOR'S RESULTS:

#### Financial Statement Accounts

32 financial statement findings, seven (7) of which are material.

#### Federal Awards and Schedule of Expenditures of Federal Awards

21 federal award findings, none of which are material.

### GENERAL TOPICS OF REPORTABLE CONDITIONS:

- Inaccurate, incomplete transaction documentation
- Inadequate technology procedures, policies, and security
- Noncompliance with federal and state laws and regulations

<u>State Organizations With Reportable Conditions:</u>	<u>State Organizations With Noncompliances:</u>
Cabinet for Families and Children Finance and Administration Cabinet Cabinet for Health Services Justice Cabinet-Office of the Secretary Department of Military Affairs Personnel Cabinet Revenue Cabinet Office of the Kentucky State Treasurer Transportation Cabinet Cabinet for Workforce Development	Kentucky Access Program Cabinet for Families and Children Finance and Administration Cabinet Cabinet for Health Services Justice Cabinet-Office of the Secretary Department of Military Affairs Council on Postsecondary Education Transportation Cabinet





EDWARD B. HATCHETT, JR.  
AUDITOR OF PUBLIC ACCOUNTS

March 31, 2003

To the People of Kentucky  
Honorable Paul E. Patton, Governor  
Gordon C. Duke, Secretary  
Finance and Administration Cabinet

As Auditor of Public Accounts, I am pleased to transmit herewith our report of the Statewide Single Audit of the Commonwealth of Kentucky for the year ended June 30, 2002. This report contains the required reports over each major program and financial statements in accordance with OMB Circular A-133 and *Government Auditing Standards*, respectively. Accompanying this report is the Commonwealth's Comprehensive Annual Financial Report, which contains our independent auditor's report on the basic financial statements of the Commonwealth issued December 20, 2002.

On behalf of the Division of Financial Audit of the Auditor of Public Account's Office, I wish to thank the employees of the Commonwealth for their cooperation during the course of our audit. Should you have any questions concerning this report, please contact Charlene Daniels, CPA, Director, Division of Financial Audit, or me.

Respectfully submitted,

A handwritten signature in cursive script, reading "Ed Hatchett".

Edward B. Hatchett, Jr.  
Auditor of Public Accounts





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## **INTRODUCTION**

**COMMONWEALTH OF KENTUCKY  
INTRODUCTION  
FOR THE YEAR ENDED JUNE 30, 2002**

Single Audit Report

The Auditor of Public Accounts (APA), acting as principal auditor in conjunction with various certified public accounting firms, annually performs a statewide single audit of the Commonwealth of Kentucky.

The APA prepares the Single Audit Report in compliance with Government Auditing Standards, Generally Accepted Government Auditing Standards, and the requirements of Office of Management and Budget (OMB) Circular A-133. The APA, on behalf of the Commonwealth of Kentucky, also prepares a reporting package as required by OMB Circular A-133. The reporting package includes the basic financial statements, Schedule of Expenditures of Federal Awards (SEFA), auditor's reports, Summary Schedule of Prior Audit Findings, and corrective action plans. For the fiscal year ended June 30, 2002 (FY 02), the Single Audit Report is presented in two volumes: the Comprehensive Annual Financial Report (CAFR) and the Single Audit Report.

The CAFR, which contains the basic financial statements and the auditor's report thereon, has been issued under separate cover.

The Single Audit Report, the second volume, contains the auditor's reports on compliance and internal control over financial reporting, compliance and internal control over compliance with requirements applicable to major federal programs, and the supplementary SEFA. The Single Audit Report also contains the SEFA, Schedule of Findings and Questioned Costs, and the Summary Schedule of Prior Audit Findings.

Schedule of Expenditures of Federal Awards

The SEFA is organized by federal grantor. The Catalog of Federal Domestic Assistance (CFDA) numbers and program names are listed under the federal grantor administering the program. The state organizations expending the federal funds are listed beside each CFDA number. The notes to the SEFA provide more detailed information on certain aspects of the expenditures. Clusters of programs are indicated in the schedule by light gray shading.

Schedule of Findings and Questioned Costs

The Schedule of Findings and Questioned Costs consists of three (3) sections: Summary of Auditor's Results, Financial Statement Findings, and Federal Award Findings and Questioned Costs. The Summary of Auditor's Results summarizes the type of audit reports issued and lists major programs audited. The Financial Statement Findings list the audit findings related to the financial statements. The Federal Award Findings and Questioned Costs lists all findings related to federal awards. In both sections, reportable conditions and reportable instances of noncompliance are presented first, then material weaknesses and material instances of noncompliance.

**COMMONWEALTH OF KENTUCKY  
INTRODUCTION  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

Summary Schedule of Prior Audit Findings

Audit findings reported in the Schedule of Findings and Questioned Costs for FY 01, as well as any previous findings that have not been resolved, are reported in the Summary Schedule of Prior Audit Findings for FY 02.

The Summary Schedule of Prior Audit Findings is organized based on whether the prior year finding was reportable or material. The findings of each classification (reportable and material) are categorized as (1) fully corrected, (2) not corrected or partially corrected, (3) corrective action taken differs significantly from corrective action previously reported, or (4) finding no longer valid or does not warrant further action.

Audit Approach

The scope of the statewide single audit for FY 02 included:

- An audit of the basic financial statements and combining and individual fund statements and schedules-non-major funds;
- Limited procedures applied to required supplementary information;
- An audit of the SEFA;
- An audit of compliance with the compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* applicable to each major federal program;
- Tests of internal control over compliance in accordance with OMB Circular A-133;
- Tests of compliance with certain provisions of laws, regulations, contracts, and grants; and
- Tests of internal control over financial reporting.

Status of State Universities

The agencies audited as part of the statewide single audit are listed in Appendix 1. The Commonwealth has elected to exclude state universities from the statewide single audit, except as part of the audit of the basic financial statements. Thus, state universities are not included in the accompanying SEFA and reports on internal control and compliance.

**COMMONWEALTH OF KENTUCKY  
INTRODUCTION  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

List Of Abbreviations/Acronyms Used In This Report

ABC	Department of Alcoholic Beverage Control
ADDs	Area Development Districts
AFR	Annual Financial Report
AGR	Department of Agriculture
AICPA	American Institute of Certified Public Accountants
AMS	American Management Systems
AOC	Administrative Office of the Courts
APA	Auditor of Public Accounts
ASMB	Assistant Secretary for Management and Budget
BRASS	Budget Reporting and Analysis Support System
CAFR	Comprehensive Annual Financial Report
CAMRA	Complete Asset Management, Reporting, and Accounting System
CAP	Cost Allocation Plan
CD	Compact Disc
CCDBG	Child Care and Development Block Grant
CCSHCN	Commission for Children with Special Health Care Needs
CFC	Cabinet for Families and Children
CFR	Code of Federal Regulations
CFDA	Catalog of Federal Domestic Assistance
CHR	Cabinet for Human Resources
CHS	Cabinet for Health Services
CICS	Customer Information Control System
Commonwealth	Commonwealth of Kentucky
CORR	Department of Corrections
Council	Council of Postsecondary Education
CPA	Certified Public Accountant
CPE	Council on Postsecondary Education
CR	Cash Receipt
CSE	Child Support Enforcement
CVC	Crime Victims Compensation Board
CWD	Cabinet for Workforce Development
DCD	Department for Community Development
DCBS	Department of Community Based Services
DCJT	Department of Criminal Justice Training
DES	Department of Employment Services
DHHS	Department of Health and Human Services
DLA	Department for Libraries and Archives

**COMMONWEALTH OF KENTUCKY  
INTRODUCTION  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

List Of Abbreviations/Acronyms Used In This Report (Continued)

DLG	Department for Local Government
DMA	Department of Military Affairs
DoS	Denial of Service
DOS	Disk Operating System
DOT	Department of Transportation
DTR	Division of Technology Resources (CHS)
DTR	Department for Training and ReEmployment (CWD)
DV	Data Validation
EDU	Department of Education
EMSB	Emergency Medical Services Board
EPA	United States Environmental Protection Agency
EPSB	Education Professional Standards Board
ERA	Employment Retention Assistance
ETA	Employment and Training Administration
F&W	Department of Fish and Wildlife Resources
FEMA	Federal Emergency Management Agency
FAC	Finance and Administration Cabinet
FHWA	Federal Highway Administration
Finance	Finance and Administration Cabinet
FMRB	Financial Management and Reporting Branch
FRC	File Requisition and Control System
FSR	Financial Status Reports
FTP	File Transfer Protocol
FUTA	Federal Unemployment Tax Administration
FY	Fiscal Year
FYC	Fiscal Year Closing
FYE	Fiscal Year End
GAAP	Generally Accepted Accounting Principles
GAO	United States General Accounting Office
GASB	Governmental Accounting Standards Board
GMB	Grants Management Branch
GOPM	Governor's Office for Policy and Management
GOT	Governor's Office for Technology
GOV	Office of the Governor
HIPAA	Health Insurance Portability and Accountability Act
HRC	Kentucky Commission on Human Rights
HTTP	Hypertext Transfer Protocol
HTTPS	Hypertext Transfer Protocol over Secure Socket Layer
IDCRP	Indirect Cost Rate Proposal

**COMMONWEALTH OF KENTUCKY  
INTRODUCTION  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

List Of Abbreviations/Acronyms Used In This Report (Continued)

ID	Identification
IIS	Internet Information Server
IRS	Internal Revenue Service
JCL	Job Control Language
JTPA	Job Training Partnership Act
JUST	Justice Cabinet – Office of the Secretary
JUV	Department of Juvenile Justice
KAC	Kentucky Arts Council
KAP	Kentucky Access Program
KAR	Kentucky Administrative Regulations
KCA	Kentucky Center for the Arts
KDE	Kentucky Department of Education
KEES	Kentucky Educational Excellence Scholarship
KEIN	Kentucky Employer Identification Number
KET	Kentucky Educational Television
KEWES	Kentucky Electronic Workplace for Employment Services
KHCOUN	Kentucky Heritage Council
KHCORP	Kentucky Housing Corporation
KHEAA	Kentucky Higher Education Assistance Authority
KHESLC	Kentucky Higher Education Student Loan Corporation
KHS	Kentucky Historical Society
KIA	Kentucky Infrastructure Authority
KRC	Kentucky Revenue Cabinet
KRS	Kentucky Revised Statutes
KSP	Kentucky State Police
KST	Office of the Kentucky State Treasurer
KY	Kentucky
KyEM	Kentucky Emergency Management
LAB	Labor Cabinet
LWIA	Local Workforce Investment Areas
M&M	Department of Mines and Minerals
MA	Department for Military Affairs
MAID	Medical Assistance Identification
MARS	Management Administrative Reporting System
MFE	Modernized Front End
MIL	Department of Military Affairs
MMIS	Medicaid Management Information System
MOA	Memorandum of Agreement
MRDB	Management Reporting Database

**COMMONWEALTH OF KENTUCKY  
INTRODUCTION  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

List Of Abbreviations/Acronyms Used In This Report (Continued)

MSDE	Microsoft Data Engine
NA	Not Applicable
NAPHSIS	National Association for Public Health Statistics and Information Systems
NDC	National Drug Code
NEMIS	National Emergency Management Information System
NREPC	Natural Resources and Environmental Protection Cabinet
NT	New Technology
OAG	Office of the Attorney General
OFM	Office of Financial Management
OIG	Office of Inspector General
OMB	Office of Management and Budget
PA	Public Assistance
PARKS	Department of Parks
PD	Procurement Desktop
PDC	Primary Domain Controller
PERS	Personnel Cabinet
Personnel	Personnel Cabinet
PRWOA	Federal Personal Responsibility and Work Opportunity Reconciliation Act
PSC	Public Service Commission
PUBAD	Department of Public Advocacy
QCSI	Quality Care Solutions, Inc.
RACF	Resource Access Control Facility
RCW	Record of Control Weakness
R&D	Research and Development
RDS	Remote Document Security
REV	Kentucky Revenue Cabinet
Revenue	Kentucky Revenue Cabinet
RFP	Request for Proposal
RHP	Replacement Housing Payments
SAS	Statements on Auditing Standards
SAS	Statistical Analysis System
SEFA	Schedule of Expenditures of Federal Awards
SF	Short Form
SIP	State Investment Pool
SQL	Structured Query Language
STARS	Statewide Accounting and Reporting System
TANF	Temporary Assistance for Needy Families

**COMMONWEALTH OF KENTUCKY  
INTRODUCTION  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

List Of Abbreviations/Acronyms Used In This Report (Continued)

TC	Transportation Cabinet
TRAV	Department of Travel
UI	Unemployment Insurance
UIA	Unemployment Insurance - Administration
UPPS	Uniform Payroll and Personnel System
UPS	Unified Prosecutorial System
U.S.	United States
USDA	United States Department of Agriculture
USDOL	United States Department of Labor
VA	Department of Veterans' Affairs
VAWA	Violence Against Women Formula Grants
VAX	Virtual Address extension (a DEC VAX is a line of mid-range computers)
VOCA	Crime Victim Assistance Grant
VSIS	Vital Statistics Information System
WIA	Workforce Investment Act
WtW	Welfare-to-Work

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**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

**COMMONWEALTH OF KENTUCKY**  
**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**FOR THE YEAR ENDED JUNE 30, 2002**

CFDA #	Program Title	State Organizations	Expenditures		Provided to Subrecipient
			Cash	Noncash	
U.S. Department of Agriculture					
Direct Programs:					
10.025	Plant and Animal Disease, Pest Control, and Animal Care	AGR	\$ 34,268	\$	\$
10.064	Forestry Incentives Program	NREPC	2,200		
10.069	Conservation Reserve Program	NREPC	14,751		
		F&W	2,772		
10.153	Market News	AGR	408		
10.156	Federal-State Marketing Improvement Program	AGR	24,472		
10.163	Market Protection and Promotion	AGR	59,329		
10.167	Transportation Services (Note 14)	AGR			
10.550	Food Donation (Note 13)	AGR		15,398,038	15,398,038
Food Stamp Cluster:					
10.551	Food Stamps (Note 2) (Note 13)	CFC		393,743,563	
10.561	State Administrative Matching Grants for Food Stamp Program (Note 2)	CFC	25,362,111		247,814
		OAG	332,307		
		CHS	191,725		
Child Nutrition Cluster:					
10.553	School Breakfast Program (Note 2)	EDU	32,509,054		32,427,626
		JUV	288,124		
10.555	National School Lunch Program (Note 2)	EDU	100,917,481		100,754,377
		JUV	454,788		
10.556	Special Milk Program for Children (Note 2)	EDU	105,684		105,684
10.559	Summer Food Service Program for Children (Note 2)	EDU	4,113,897		3,987,051
10.557	Special Supplemental Nutrition Program for Women, Infants, and Children (Note 2)	CHS	82,607,353		16,214,985
10.558	Child and Adult Care Food Program (Note 2)	EDU	24,738,134		24,449,067
10.560	State Administrative Expenses for Child Nutrition	EDU	1,581,664		
		AGR	160,930		
10.565	Commodity Supplemental Food Program (Note 4) (Note 13)	AGR	223,280	1,447,520	
Emergency Food Assistance Cluster:					
10.568	Emergency Food Assistance Program (Administrative Costs)	AGR	918,309		
		GOV	150,000		
10.569	Emergency Food Assistance Program (Food Commodities) (Note 13)	AGR		6,081,856	
10.570	Nutrition Services Incentive	CHS	2,573,718		2,573,718
10.572	WIC Farmers' Market Nutrition Program (FMNP)	AGR	141,832		
10.652	Forestry Research	NREPC	405,558		
10.664	Cooperative Forestry Assistance	NREPC	2,584,898		297,985
10.672	Rural Development, Forestry, and Commodities	NREPC	1,063		
10.766	Community Facilities Loans and Grants (Note 2) (Note 3e) (Note 13)	KHCORP		66,566,478	

**COMMONWEALTH OF KENTUCKY**

See accompanying Notes to the Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

CFDA #	Program Title	State Organizations	Expenditures		Provided to Subrecipient
			Cash	Noncash	
<b><u>U.S. Department of Agriculture (Continued)</u></b>					
<b>Direct Programs (Continued):</b>					
10.769	Rural Business Enterprise Grants (Note 14)	AGR	8,930		
		DLG			
10.771	Rural Cooperative Development Grants (Note 14)	AGR			
10.901	Resource Conservation and Development	NREPC	1,126		
10.912	Environmental Quality Incentives Program	NREPC	38,756		
10.914	Wildlife Habitat Incentive Program (Note 13)	F&W	58,383	21,000	
NA	Natural Resources Soil Conservation Program (Note 13)	NREPC		30,455	
NA	Rural Rehabilitation Student Loan Program (Note 3a)	AGR	107,993		
<b>Total U.S. Department of Agriculture</b>			<b>\$ 280,715,298</b>	<b>\$ 483,288,910</b>	<b>\$ 196,456,345</b>
<b><u>U.S. Department of Commerce</u></b>					
<b>Direct Programs:</b>					
11.305	Economic Development - State and Local Economic Development Planning	DLG	\$ 6,000		\$ 6,000
<b>Public Works and Economic Development Cluster:</b>					
11.307	Economic Adjustment Assistance (Note 3b) (Note 14)	DLG			
11.450	Integrated Flood Observing and Warning System (IFLOWS)	MIL	41,782		
11.550	Public Telecommunications Facilities-Planning and Construction (Note 2)	KET	266,894		
<b>Passed Through From Personal Responsibility in A Desirable Environment:</b>					
11.469	Congressionally Identified Construction Projects Pass Through Grantor's # - NA	NREPC	96,506		
<b>Total U.S. Department of Commerce</b>			<b>\$ 411,182</b>		<b>\$ 6,000</b>
<b><u>U.S. Department of Defense</u></b>					
<b>Direct Programs:</b>					
12.002	Procurement Technical Assistance For Business Firms	DCD	\$ 128,727		\$
12.113	State Memorandum of Agreement Program for the Reimbursement of Technical Services	NREPC	398,856		
12.401	National Guard Military Operations and Maintenance (O & M) Projects	MIL	8,377,033		
12.404	National Guard Civilian Youth Opportunities	MIL	1,879,219		
NA	Chemical Demilitarization and Remediation Activity for Hazardous Waste Activities at Chemical Demilitarization Facilities	NREPC	98,265		11,599
NA	Teacher and Teacher's Aide Placement Assistance Program	EPSB	80,922		
NA	Monitoring of Wildlife	F&W	20,117		
<b>Total U.S. Department of Defense</b>			<b>\$ 10,983,139</b>		<b>\$ 11,599</b>

See accompanying Notes to the Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

CFDA #	Program Title	State Organizations	Expenditures		Provided to Subrecipient
			Cash	Noncash	
U.S. Department of Housing and Urban Development					
Direct Programs:					
14.117	Mortgage Insurance - Homes (Note 2) (Note 3e) (Note 13)	KHCORP	\$	\$ 128,011,580	\$
14.169	Housing Counseling Assistance Program	KHCORP		27,648	
Section 8 Project-Based Cluster:					
14.182	Lower Income Housing Assistance Program-Section 8 New Construction/Substantial Rehabilitation (Note 2)	KHCORP		86,146,058	
14.856	Lower Income Housing Assistance Program-Section 8 Moderate Rehabilitation (Note 2)	KHCORP		468,566	
14.185	Homeownership and Opportunity for People Everywhere	KHCORP		22,688	20,419
14.227	Community Development Block Grants/Special Purpose Grants/Technical Assistance Program (Note 14)	DLG			
14.228	Community Development Block Grants/State's Program (Note 2) (Note 10)	DLG		41,356,553	40,871,955
14.230	Rental Housing Rehabilitation (Note 14)	DLG			
14.231	Emergency Shelter Grants Program (Note 14)	KHCORP		1,220,840	1,198,420
		DLG			
14.235	Supportive Housing Program (Note 2)	KHCORP		3,302,310	3,247,214
14.238	Shelter Plus Care	KHCORP		333,991	167,191
14.239	HOME Investment Partnerships Program (Note 2)	KHCORP		20,004,568	12,317,301
14.241	Housing Opportunities for Persons with AIDS	KHCORP		815,150	796,823
14.401	Fair Housing Assistance Program-State and Local	HRC		130,230	
14.408	Fair Housing Initiatives and Administrative Enforcement Initiative Program	HRC		26,431	
14.409	Fair Housing Initiatives Program (FHIP) Education and Outreach Initiative	HRC		36	
14.855	Section 8 Rental Voucher Program (Note 14)	KHCORP			
14.857	Section 8 Rental Certificate Program (Note 14)	KHCORP			
14.871	Section 8 Housing Choice Vouchers (Note 2)	KHCORP		15,425,269	
NA	HUD Disaster Recovery Initiative	DLG		330,670	330,670
Total U.S. Department of Housing and Urban Development			\$	169,611,008	\$ 128,011,580 \$ 58,949,993

**U.S. Department of the Interior**

**Direct Programs:**

15.250	Regulation of Surface Coal Mining and Surface Effects of Underground Coal Mining (Note 13)	NREPC	\$ 12,598,057	\$ 50,372	\$ 13,808
15.252	Abandoned Mine Land Reclamation (AMLR) Program (Note 2) (Note 13)	NREPC	19,639,488	40,600	8,623,967
		KIA	98,372		98,372
		TC	57,150		

**U.S. Department of the Interior (Continued)**

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**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

CFDA #	Program Title	State Organizations	Expenditures		Provided to Subrecipient
			Cash	Noncash	
Direct Programs (Continued):					
Fish and Wildlife Cluster:					
15.605	Sport Fish Restoration (Note 9)	F&W	3,883,268		
15.611	Wildlife Restoration (Note 9) (Note 11)	F&W	3,458,257		
15.608	Fish and Wildlife Management Assistance	NREPC	1,716		
15.615	Cooperative Endangered Species Conservation Fund (Note 9)	F&W	133,987		
		NREPC	22,184		
15.616	Clean Vessel Act	F&W	37,397		
15.617	Wildlife Conservation and Appreciation (Note 9)	F&W	55,850		
15.618	Administrative Grants for Federal Aid in Sport Fish and Wildlife Restoration	F&W	2,200		
15.622	Sportfishing and Boating Safety Act	F&W	50,000		
15.623	North American Wetlands Conservation Fund	F&W	7,690		
15.625	Wildlife Conservation and Restoration (Note 9)	F&W	405,845		
15.634	State Wildlife Grants (Note 14)	F&W			
15.808	U.S. Geological Survey-Research and Data Acquisition (Note 13)	NREPC		209,767	
15.810	National Cooperative Geologic Mapping Program (Note 9)	F&W	119,969		
15.904	Historic Preservation Fund Grants-In-Aid	KHCOUN	753,910		201,798
15.916	Outdoor Recreation-Acquisition, Development and Planning (Note 7)	DLG	399,146		399,146
NA	Water Investigation at Maxey Flats (Note 13)	NREPC		58,500	
NA	Wolf Creek National Fish Hatchery	F&W	4,059		
NA	National Fish and Wildlife Foundation-Restoration of Elk Habitat in Kentucky (Note 9)	F&W	34,060		
Total U.S. Department of the Interior			\$ 41,762,605	\$ 359,239	\$ 9,337,091
U.S. Department of Justice					
Direct Programs:					
16.007	State Domestic Preparedness Equipment Support Program	MIL	\$ 118,476		\$
16.523	Juvenile Accountability Incentive Block Grants	JUV	4,015,543		540,270
		AOC	71,716		
		UPS	56,881		
		PUBAD	42,541		
16.540	Juvenile Justice and Delinquency Prevention-Allocation to States	JUV	1,039,469		898,479
		AOC	2,816		
16.541	Juvenile Justice and Delinquency Prevention-Special Emphasis	AOC	27,919		
16.542	National Institute for Juvenile Justice and Delinquency Prevention	JUV	1,279,302		1,279,302
16.548	Title V-Delinquency Prevention Program	JUV	420,727		406,313
16.549	Part E-State Challenge Activities	JUV	126,007		126,007

**U.S. Department of Justice (Continued)**

**Direct Programs (Continued):**

See accompanying Notes to the Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

CFDA #	Program Title	State Organizations	Expenditures		Provided to Subrecipient
			Cash	Noncash	
16.550	State Justice Statistics Program for Statistical Analysis Centers (Note 14)	JUST OAG	80,528		
16.554	National Criminal History Improvement Program (NCHIP) (Note 14)	KSP CORR	800,400		
16.560	National Institute of Justice Research, Evaluation, and Development Project Grants (Note 14)	JUST KSP			
16.575	Crime Victim Assistance	JUST	5,009,885		4,874,376
		UPS	570,272		
16.576	Crime Victim Compensation	CVC	410,967		
16.579	Byrne Formula Grant Program (Note 14)	JUST	3,673,905		3,440,318
		KSP	1,769,041		
		CORR	943,627		
		AOC	909,654		76,213
		JUV	129,621		129,621
		OAG	108,551		
		UPS	28,023		
		HRC	3,336		3,336
		PUBAD			
16.580	Edward Byrne Memorial State and Local Law Enforcement Assistance Discretionary Grants Program	AOC	1,529,236		
		JUST	815,465		
		CORR	31,373		
		CFC	22,386		
		DCJT	16,144		
		KSP	258		
16.582	Crime Victim Assistance/Discretionary Grants (Note 14)	OAG			
16.585	Drug Court Discretionary Grant Program (Note 9)	AOC	466,133		
16.586	Violent Offender Incarceration and Truth in Sentencing Incentive Grants	CORR	964,580		
		JUV	461,282		
		JUST	26,112		
16.588	Violence Against Women Formula Grants	JUST	1,667,791		1,589,094
		UPS	175,360		
		OAG	73,656		
		GOV	49,659		
16.589	Rural Domestic Violence and Child Victimization Enforcement Grant Program	JUST	105,038		105,038
16.590	Grants to Encourage Arrest Policies and Enforcement of Protection Orders	JUST	60,897		60,897
16.592	Local Law Enforcement Block Grants Program (Note 14)	KSP	719,150		
		JUST	490,199		441,449
		AOC	8,967		
		PARKS			
16.593	Residential Substance Abuse Treatment for State Prisoners (Note 14)	CORR	689,083		
		JUST			

**U.S. Department of Justice (Continued)**

**Direct Programs (Continued):**

16.606 State Criminal Alien Assistance Program (Note 14) CORR

See accompanying Notes to the Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

CFDA #	Program Title	State Organizations	Expenditures		Provided to Subrecipient
			Cash	Noncash	
16.607	Bulletproof Vest Partnership Program (Note 14)	JUST	19,518		3,190
		KSP	15,550		
		F&W			
16.710	Public Safety Partnership and Community Policing Grants (Note 14)	KSP	462,444		
		CORR	8,563		
		JUST			
16.712	Police Corps	DCJT	1,315,639		
16.727	Enforcing Underage Drinking Laws Program	KSP	218,526		111,997
		ABC	107,585		
16.728	Drug Prevention Program	TC	252,225		
NA	Drug Enforcement Administration Program	KSP	728,883		
NA	Federal Bureau of Investigation Program	KSP	9,291		
NA	Federal Methamphetamine Initiative Program	KSP	353,172		
<b>Passed Through From Eastern Kentucky University:</b>					
16.710	Public Safety Partnership and Community Policing Grants Pass Through Grantor's # - 97-CK-WX-1	DCJT	51,870		
<b>Total U.S. Department of Justice</b>			<u>\$ 33,555,242</u>		<u>\$ 14,085,900</u>
<b><u>U.S. Department of Labor</u></b>					
<b>Direct Programs:</b>					
17.002	Labor Force Statistics	CWD	\$ 996,378		\$
17.005	Compensation and Working Conditions	LAB	111,919		
17.203	Labor Certification for Alien Workers	CWD	301,735		
<b>Employment Services Cluster:</b>					
17.207	Employment Service	CWD	10,206,628		
17.801	Disabled Veterans' Outreach Program (DVOP)	CWD	817,796		
17.804	Local Veterans' Employment Representative Program	CWD	851,091		
17.225	Unemployment Insurance (Note 2) (Note 5)	CWD	570,264,827		18,989
17.235	Senior Community Service Employment Program	CHS	1,666,319		1,615,886
17.245	Trade Adjustment Assistance-Workers	CWD	14,423,708		
17.253	Welfare-to-Work Grants to States and Localities (Note 14)	CFC	1,931,493		2,035,224
		CHS	205		
		CWD			
17.255	Workforce Investment Act (Note 2) (Note 12)	CWD	21,609,832		20,051,492
<b>Workforce Investment Act Cluster:</b>					
17.258	WIA Adult Program (Note 2)	CWD	13,241,025		12,191,494
17.259	WIA Youth Activities (Note 2)	CWD	3,999,874		3,811,628
		EDU	709,279		671,428
17.260	WIA Dislocated Workers (Note 2)	CWD	11,450,753		10,831,049
<b><u>U.S. Department of Labor (Continued)</u></b>					
<b>Direct Programs (Continued):</b>					
17.263	Youth Opportunity Grants	CWD	53,510		41,147
17.267	WIA Incentive Grants	CWD	73,549		68,150

See accompanying Notes to the Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

CFDA #	Program Title	State Organizations	Expenditures		Provided to Subrecipient
			Cash	Noncash	
17.503	Occupational Safety and Health-State Program	LAB	3,162,407		
17.504	Consultation Agreements	LAB	36,506		
17.600	Mine Health and Safety Grants	M&M	592,700		
NA	National Occupational Information Coordinating Committee (Note 14)	CWD			
<b>Total U.S. Department of Labor</b>			<u>\$ 656,501,534</u>		<u>\$ 51,336,487</u>
<b><u>U.S. Department of Transportation</u></b>					
<b>Direct Programs:</b>					
20.005	Boating Safety Financial Assistance	F&W	\$ 1,187,869		\$
20.106	Airport Improvement Program (Note 14)	TC			
<b>Highway Planning and Construction Cluster:</b>					
20.205	Highway Planning and Construction (Note 2) (Note 6) (Note 15)	TC	522,066,210		
20.218	National Motor Carrier Safety	TC	1,678,824		36,006
		KSP	6,029		
20.219	Recreational Trails Program (Note 7)	DLG	680,777		586,957
		PARKS	13,805		
20.505	Federal Transit-Metropolitan Planning Grants	TC	340,365		337,047
<b>Federal Transit Cluster:</b>					
20.507	Federal Transit-Formula Grants	TC	4,149,455		4,149,455
20.509	Formula Grants for Other Than Urbanized Areas	TC	4,920,029		4,619,036
20.513	Capital Assistance Program for Elderly Persons and Persons with Disabilities	TC	1,137,731		1,137,731
<b>Highway Safety Cluster:</b>					
20.600	State and Community Highway Safety (Note 14)	KSP	3,473,245		1,601,466
		TC	267,750		
		CHS	74,956		
		DCJT			
20.604	Safety Incentive Grants for Use of Seatbelts	KSP	623,269		430,292
20.605	Safety Incentives to Prevent Operation of Motor Vehicles by Intoxicated Persons	KSP	1,009,125		
20.700	Pipeline Safety	PSC	253,536		
20.703	Interagency Hazardous Materials Public Sector Training and Planning Grants	MIL	241,457		
<b><u>U.S. Department of Transportation (Continued)</u></b>					
<b>Direct Programs (Continued):</b>					
NA	Joint Federal/State Motor Fuel Tax Compliance Project	REV	15,044		
NA	National Highway Traffic Safety Administration Program	KSP	33,358		

See accompanying Notes to the Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

CFDA #	Program Title	State Organizations	Expenditures		Provided to Subrecipient
			Cash	Noncash	
Total U.S. Department of Transportation			\$	542,172,834	\$ 12,897,990
<u>U.S. Department of Treasury</u>					
Direct Programs:					
NA	Internal Revenue Service Program	KSP	\$	3,426	
Total U.S. Department of Treasury			\$	3,426	
<u>U.S. Appalachian Regional Commission</u>					
Direct Programs:					
23.001	Appalachian Regional Development	DLG	\$	55,418	\$
23.002	Appalachian Area Development	DLG		114,628	114,628
23.005	Appalachian Housing Project Planning Loan, Technical Assistance Grant and Site Development and Off-Site Improvement Grant-State Appalachian Housing Programs (Note 14)	KHCORP DLG		1,172,488	
23.011	Appalachian State Research, Technical Assistance, and Demonstration Projects (Note 9)	DLG GOV		180,880 100,000	180,870
NA	Kentucky Appalachian Motorcoach Tourism Planning Grant	TRAV		63,937	
Total U.S. Appalachian Regional Commission			\$	1,687,351	\$ 295,498
<u>U.S. Equal Employment Opportunity Commission</u>					
Direct Programs:					
30.002	Employment Discrimination-State and Local Fair Employment Practices Agency Contracts	HRC	\$	84,743	
Total U.S. Equal Employment Opportunity Commission			\$	84,743	
<u>U.S. General Services Administration</u>					
Direct Programs:					
39.003	Donation of Federal Surplus Personal Property (Note 13)	FAC		\$ 799,538	
Total U.S. General Services Administration				\$ 799,538	
<u>U.S. National Foundation on the Arts and the Humanities</u>					
Direct Programs:					
45.015	Promotion of the Arts-Folk and Traditional Arts	KHS	\$	40,000	\$
45.024	Promotion of the Arts-Grants to Organizations and Individuals	KET		50,000	
45.025	Promotion of the Arts-Partnership Agreements	KAC		524,470	217,547
<u>U.S. National Foundation on the Arts and the Humanities (Continued)</u>					
Direct Programs (Continued):					
45.026	Promotion of the Arts-Leadership Initiatives (Note 14)	KHS KAC		30,000	
45.129	Promotion of the Humanities-Federal/State Partnership	KHS		7,337	

See accompanying Notes to the Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
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(CONTINUED)**

CFDA #	Program Title	State Organizations	Expenditures		Provided to Subrecipient
			Cash	Noncash	
45.310	State Library Program	DLA	1,820,394		589,348
<b>Passed Through From the Kentucky Humanities Council:</b>					
45.129	Promotion of the Humanities-Federal/State Partnership Pass Through Grantor's # - NA	KCA	1,500		
<b>Total U.S. National Foundation on the Arts and Humanities</b>			<u>\$ 2,473,701</u>		<u>\$ 806,895</u>
<b><u>U.S. Department of Veterans Affairs</u></b>					
<b>Direct Programs:</b>					
64.005	Grants to States for Construction of State Home Facilities	VA	\$ 7,255,476	\$	
64.114	Veterans Housing-Guaranteed and Insured Loans (Note 2) (Note 3e) (Note 13)	KHCORP		9,324,960	
<b>Total U.S. Department of Veterans Affairs</b>			<u>\$ 7,255,476</u>	<u>\$ 9,324,960</u>	
<b><u>U.S. Environmental Protection Agency</u></b>					
<b>Direct Programs:</b>					
66.001	Air Pollution Control Program Support (Note 13)	NREPC	\$ 1,301,597	\$ 30,000	\$
66.032	State Indoor Radon Grants	CHS	195,513		129,849
66.419	Water Pollution Control-State and Interstate Program Support	NREPC	1,485,520		
66.432	State Public Water System Supervision	NREPC	1,031,510		
66.438	Construction Management Assistance	NREPC	384,505		
66.454	Water Quality Management Planning	NREPC	80,459		20,000
66.458	Capitalization Grants for State Revolving Funds (Note 2) (Note 3d)	KIA	10,007,125		9,639,295
		NREPC	628,059		
66.460	Nonpoint Source Implementation Grants	NREPC	2,675,241		
66.461	Wetlands Grants	F&W	57,932		
		NREPC	14,039		13,838
66.463	Water Quality Cooperative Agreements (Note 13)	NREPC	60,359	60,000	60,359
66.467	Wastewater Operator Training Grant Program (Technical Assistance)	NREPC	49,867		
66.468	Capitalization Grants for Drinking Water State Revolving Fund (Note 2) (Note 3d)	KIA	16,807,935		16,378,395
		NREPC	1,206,857		
66.470	Hardship Grants Program for Rural Communities (Note 14)	NREPC			
66.606	Surveys, Studies, Investigations and Special Purpose Grants (Note 13)	NREPC	322,223	190,710	30,000
		CHS	159,134		1,883
66.700	Consolidated Pesticide Enforcement Cooperative Agreements	AGR	508,556		
66.701	Toxic Substances Compliance Monitoring Cooperative Agreements	NREPC	68,516		
<b><u>U.S. Environmental Protection Agency (Continued)</u></b>					
<b>Direct Programs (Continued):</b>					
66.707	TSCA Title IV State Lead Grants - Certification of Lead- Based Paint Professionals	CHS	281,957		
66.708	Pollution Prevention Grants Program (Note 14)	NREPC			

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**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED JUNE 30, 2002  
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CFDA #	Program Title	State Organizations	Expenditures		Provided to Subrecipient
			Cash	Noncash	
66.709	Capacity Building Grants and Cooperative Agreements for States and Tribes (Note 13)	NREPC		49,285	
66.801	Hazardous Waste Management State Program Support	NREPC	1,710,979		
66.802	Superfund State, Political Subdivision, and Indian Tribe Site-Specific Cooperative Agreements	NREPC	95,142		
66.804	State and Tribal Underground Storage Tanks Program	NREPC	186,675		
66.805	Leaking Underground Storage Tank-Trust Fund	NREPC	1,249,356		
66.809	Superfund State and Indian Tribe Core Program-Cooperative Agreements	NREPC	209,392		
<b>Total U.S. Environmental Protection Agency</b>			<b>\$ 40,778,448</b>	<b>\$ 329,995</b>	<b>\$ 26,273,619</b>
<b><u>U.S. Department of Energy</u></b>					
<b>Direct Programs:</b>					
81.039	Nation Energy Information Center	NREPC	\$ 7,119		\$
81.041	State Energy Program	NREPC	661,020		96,406
81.042	Weatherization Assistance for Low-Income Persons	CFC	3,002,036		2,846,777
		CHS	96,374		
81.086	Conservation Research and Development	NREPC	16,625		
81.089	Fossil Energy Research and Development	M&M	12,475		
81.106	Transport of Transuranic Wastes to the Waste Isolation Pilot Plant: States and Tribal Concerns, Proposed Solutions	MIL	63,111		
		CHS	22,043		
81.117	Energy Efficiency and Renewable Energy Information Dissemination, Outreach, Training and Technical Analysis/Assistance	NREPC	9,521		
81.119	State Energy Program Special Projects	NREPC	149,818		142,468
81.502	Paducah Gaseous Diffusion Plant Environmental Monitoring and Oversight	NREPC	1,433,552		123,202
		CHS	389,371		112,536
<b>Total U.S. Department of Energy</b>			<b>\$ 5,863,065</b>		<b>\$ 3,321,389</b>
<b><u>U.S. Federal Emergency Management Agency</u></b>					
<b>Direct Programs:</b>					
83.012	Hazardous Materials Assistance Program	MIL	\$ 4,317		\$
83.105	Community Assistance Program-State Support Services Element (CAP-SSSE)	NREPC	72,951		
83.536	Flood Mitigation Assistance (Note 14)	MIL			
83.539	Crisis Counseling	MIL	54,821		
83.543	Individual and Family Grants	MIL	4,542,103		
83.544	Public Assistance Grants	MIL	5,278,121		5,278,712
		TC	1,485,979		
83.545	Disaster Housing Program	MIL	202,424		
<b><u>U.S. Federal Emergency Management Agency (Continued)</u></b>					
<b>Direct Programs (Continued):</b>					
83.548	Hazard Mitigation Grant	MIL	1,276,149		1,275,833
83.549	Chemical Stockpile Emergency Preparedness Program	MIL	4,369,296		3,646,574
		CHS	140,145		76,610
83.550	National Dam Safety Program	NREPC	9,460		

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**COMMONWEALTH OF KENTUCKY  
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CFDA #	Program Title	State Organizations	Expenditures		Provided to Subrecipient
			Cash	Noncash	
83.552	Emergency Management Performance Grants	MIL	2,180,627		564,767
83.556	Fire Management Assistance Grant (Note 14)	MIL			
83.557	Pre-Disaster Mitigation	MIL	1,000		
<b>Total U.S. Federal Emergency Management Agency</b>			<b>\$ 19,617,393</b>		<b>\$ 10,842,496</b>
<b>U.S. Department of Education</b>					
<b>Direct Programs:</b>					
84.002	Adult Education-State Grant Program	KET	\$ 74,099		\$
		CWD	8,894,085		8,410,863
84.010	Title I Grants to Local Educational Agencies (Note 2)	EDU	130,211,327		128,811,261
84.011	Migrant Education - State Grant Program	EDU	9,255,760		8,968,508
84.013	Title I Program for Neglected and Delinquent Children	JUV	615,352		
		CORR	57,879		
		EDU	6,101		
84.023	Special Education - Innovation and Development	EDU	44,564		44,579
<b>Special Education Cluster:</b>					
84.027	Special Education - Grants to States (Note 2)	EDU	78,960,489		74,900,677
84.173	Special Education - Preschool Grants (Note 2)	EDU	10,392,278		9,947,090
<b>Student Financial Assistance Programs Cluster:</b>					
84.032	Federal Family Education Loans (Note 2) (Note 3c)	KHEAA	45,665,348		
		KHESLC	14,871,899		
84.048	Vocational Education-Basic Grants to States	CWD	8,336,140		6,166,763
		EDU	7,582,899		7,201,846
84.069	Leveraging Educational Assistance Partnership	KHEAA	753,617		
84.126	Rehabilitation Services-Vocational Rehabilitation Grants to States (Note 2)	CWD	42,904,112		783,549
		EDU	2,774		(140)
84.128	Rehabilitation Services-Service Projects	CWD	145,271		145,194
84.161	Rehabilitation Services-Client Assistance Program	CWD	148,963		
84.162	Immigrant Education	EDU	481,078		474,981
84.169	Independent Living-State Grants	CWD	250,070		
84.177	Rehabilitation Services-Independent Living Services for Older Individuals Who are Blind	CWD	295,841		
84.181	Special Education-Grants for Infants and Families with Disabilities	CCSHCN	4,680,613		
		CHS	2,514,688		579,039
		EDU	60,399		
84.185	Byrd Honors Scholarships	EDU	512,770		516,543
<b>U.S. Department of Education (Continued)</b>					
<b>Direct Programs (Continued):</b>					
84.186	Safe and Drug-Free Schools and Communities-State Grants	EDU	5,930,810		5,243,136
		CHS	1,212,864		1,212,863
		KSP	51,095		
		GOV	23,227		

See accompanying Notes to the Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

CFDA #	Program Title	State Organizations	Expenditures		Provided to Subrecipient
			Cash	Noncash	
84.187	Supported Employment Services for Individuals with Severe Disabilities	CWD	469,804		
84.194	Bilingual Education Support Services	EDU	50,170		
84.196	Education for Homeless Children and Youth	EDU	553,966		538,096
84.203	Star Schools (Note 14)	KET			
84.213	Even Start - State Educational Agencies	EDU	2,695,073		2,665,954
84.215	Fund for the Improvement of Education	EDU	423,531		416,847
84.216	Capital Expenses	EDU	77,608		80,984
84.224	Assistive Technology	CWD	1,389,432		241,828
84.240	Program of Protection and Advocacy of Individual Rights	PUBAD	151,857		
84.243	Tech-Prep Education	CWD	3,056,906		1,439,462
84.265	Rehabilitation Training-State Vocational Rehabilitation Unit In-Service Training	CWD	125,924		
84.276	Goals 2000 - State and Local Education Systemic Improvement Grants	EDU	5,893,336		5,580,532
84.278	School to Work Opportunities	CWD	208,366		184,522
84.281	Eisenhower Professional Development State Grants (Note 2)	EDU	4,396,680		3,864,762
		CPE	702,952		667,217
84.293	Foreign Language Assistance	EDU	53,801		11,951
84.298	Innovative Education Program Strategies	EDU	5,064,744		4,372,260
		KCA	25,000		
84.314	Even Start - Statewide Family Literacy Program	EDU	266,244		
84.318	Technology Literacy Challenge Fund Grants	EDU	6,833,345		6,639,382
84.323	Special Education-State Program Improvement Grants for Children with Disabilities	EDU	966,884		920,603
		CHS	63,818		36,077
		CCSHCN	41,892		
84.326	Special Education - Technical Assistance and Dissemination to Improve Services and Results for Children with Disabilities	EDU	231,920		231,920
84.327	Special Education - Technology and Media Services for Individuals with Disabilities	EDU	38,395		38,395
84.330	Advanced Placement Program	EDU	330,577		24,905
84.331	Grants to States for Incarcerated Youth Offenders	CORR	215,495		
84.332	Comprehensive School Reform Demonstration	EDU	3,139,187		2,954,300
84.334	Gaining Early Awareness and Readiness for Undergraduate Programs (Note 2)	CPE	2,047,561		1,421,346
84.338	Reading Excellence	EDU	3,287,916		3,208,488
84.340	Class Size Reduction (Note 2)	EDU	23,299,389		22,991,762
84.343	Assistive Technology - State Grants for Protection and Advocacy	PUBAD	24,017		
84.346	Occupational and Employment Information State Grants	CWD	158,272		5,700

**U.S. Department of Education (Continued)**

**Direct Programs (Continued):**

84.348	Title I Accountability Grants	EDU	889,705		889,705
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**Passed Through From the Public Broadcasting Service:**

84.203	Star Schools	KET	4,218		
	Pass Through Grantor's # - NA				

See accompanying Notes to the Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

CFDA #	Program Title	State Organizations	Expenditures		Provided to Subrecipient
			Cash	Noncash	
Total U.S. Department of Education			\$	442,114,397	\$ 312,833,750
U.S. Department of Health and Human Services					
Direct Programs:					
93.003	Public Health and Social Services Emergency Fund	CHS	\$	100,000	\$
93.041	Special Programs for the Aging - Title VII, Chapter 3 - Programs for Prevention of Elder Abuse, Neglect, and Exploitation	CHS		65,760	65,760
93.042	Special Programs for the Aging - Title VII, Chapter 2 - Long Term Care Ombudsman Services for Older Individuals	CHS		120,264	51,035
93.043	Special Programs for the Aging - Title III, Part D - Disease Prevention and Health Promotion Services	CHS		316,075	313,746
Aging Cluster:					
93.044	Special Programs for the Aging - Title III, Part B - Grants for Supportive Services and Senior Centers	CHS		4,970,611	4,719,861
93.045	Special Programs for the Aging - Title III, Part C - Nutrition Services	CHS		7,327,533	6,964,340
93.046	Special Programs for the Aging - Title III, Part D - In-Home Services for Frail Older Individuals	CHS		43,527	
93.048	Special Programs for the Aging - Title IV and Title II- Discretionary Projects	CHS		13,785	13,785
93.052	National Family Caregiver Support	CHS		1,232,759	1,165,419
93.103	Food and Drug Administration - Research	CHS		4,000	
93.104	Comprehensive Community Mental Health Services for Children with Serious Emotional Disturbances (SED)	CHS		1,565,793	1,564,550
93.110	Maternal and Child Health Federal Consolidated Programs	CCSHCN		382,036	
		CHS		179,457	
93.116	Project Grants and Cooperative Agreements for Tuberculosis Control Programs (Note 13)	CHS		1,014,425	80,905 814,578
93.119	Grants for Technical Assistance Activities Related to the Block Grant for Community Mental Health Services - Technical Assistance Centers for Evaluation	CHS		59,228	59,228
93.127	Emergency Medical Services for Children	EMSB		124,848	
93.130	Primary Care Services - Resource Coordination and Development	CHS		77,044	53,175
93.136	Injury Prevention and Control Research and State and Community Based Programs	CHS		617,918	617,918
U.S. Department of Health and Human Services (Continued)					
Direct Programs (Continued):					
93.138	Protection and Advocacy for Individuals with Mental Illness	PUBAD		328,408	
93.150	Projects for Assistance In Transition from Homelessness (PATH)	CHS		300,000	300,000
93.197	Childhood Lead Poisoning Prevention Projects - State and Local Childhood Lead Poisoning Prevention and Surveillance of Blood Lead Levels in Children	CHS		137,902	

See accompanying Notes to the Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

CFDA #	Program Title	State Organizations	Expenditures		Provided to Subrecipient
			Cash	Noncash	
93.217	Family Planning - Services	CHS	4,675,493		4,484,717
93.230	Consolidated Knowledge Development and Application (KD&A) Program (Note 9)	CHS	3,405,317		3,405,317
93.235	Abstinence Education	CHS	1,050,177		998,135
93.238	Cooperative Agreements for State Treatment Outcomes and Performance Pilot Studies Enhancement (Note 9)	CHS	392,556		330,285
93.251	Universal Newborn Hearing Screening	CCSHCN	161,557		
93.262	Occupational Safety and Health Research Grants	CHS	61,560		61,560
93.268	Immunization Grants (Note 13)	CHS	2,902,603	11,697,542	1,874,493
93.283	Centers for Disease Control and Prevention-Investigations and Technical Assistance	CHS	2,469,006		2,085,218
		CCSHCN	90,708		
93.556	Promoting Safe and Stable Families	CFC	5,362,740		3,137,180
		CHS	1,577		
93.558	Temporary Assistance for Needy Families (Note 2)	CFC	188,712,921		12,922,364
		CWD	3,288,926		
		KHCORP	2,736,519		
		OAG	405,199		
		CHS	220,669		
93.563	Child Support Enforcement (Note 2)	CFC	43,140,200		21,767,181
		OAG	147,577		
		CHS	15,042		
93.568	Low-Income Home Energy Assistance (Note 2)	CFC	22,998,589		22,803,247
		CHS	15,037		
93.569	Community Services Block Grant	CFC	10,504,445		10,402,583
		CHS	16,502		
93.571	Community Services Block Grant Discretionary Awards-Community Food and Nutrition	CFC	63,025		63,025
<b>Child Care Cluster:</b>					
93.575	Child Care and Development Block Grant (Note 2)	CFC	16,236,252		11,699,573
93.596	Child Care Mandatory and Matching Funds of the Child Care and Development Fund (Note 2)	CFC	50,781,166		64,935
		CHS	2,328,613		
93.576	Refugee and Entrant Assistance - Discretionary Grants	EDU	284,321		276,484
93.585	Empowerment Zones Program	FAC	3,388,344		3,388,344
93.586	State Court Improvement Program	AOC	71,801		
93.597	Grants to States for Access and Visitation Programs	CFC	146,612		146,874
93.600	Head Start	GOV	118,871		
93.603	Adoption Incentive Payments	CFC	164,001		7,368
<b>U.S. Department of Health and Human Services (Continued)</b>					
<b>Direct Programs (Continued):</b>					
93.623	Runaway and Homeless Youth	JUV	59,376		59,376
93.630	Developmental Disabilities Basic Support and Advocacy Grants	CHS	1,158,051		557,608
		PUBAD	435,685		
		CWD	118,000		
		EDU	73,000		
		KET	9,206		
93.643	Children's Justice Grants to States	AOC	100,724		

See accompanying Notes to the Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

CFDA #	Program Title	State Organizations	Expenditures		Provided to Subrecipient
			Cash	Noncash	
		CFC	19,989		7,524
		OAG	7,396		
93.645	Child Welfare Services-State Grants	CFC	4,544,222		
93.652	Adoption Opportunities	AOC	8,236		
93.658	Foster Care-Title IV-E (Note 2)	CFC	48,820,494		53,774
		JUV	1,017,844		
		AOC	217,461		
		CHS	109,196		
93.659	Adoption Assistance	CFC	13,474,440		
93.667	Social Services Block Grant (Note 2)	CFC	14,479,448		225,088
		JUV	7,733,779		
		CHS	140,627		125,755
93.669	Child Abuse and Neglect State Grants	CFC	1,269,324		974,279
		OAG	1,000		
		CHS	119		
93.671	Family Violence Prevention and Services/Grants for Battered Women's Shelters-Grants to States and Indian Tribes	CFC	1,179,778		1,176,342
		CHS	3,406		
93.674	Chafee Foster Care Independent Living	CFC	1,877,675		488,048
		CHS	11		
93.767	State Children's Insurance Program (Note 2)	CHS	59,841,382		412,280
		CFC	920,851		
<b>Medicaid Cluster:</b>					
93.775	State Medicaid Fraud Control Units (Note 2)	OAG	1,044,574		
93.777	State Survey and Certification of Health Care Providers and Suppliers (Note 2)	CHS	5,206,307		
93.778	Medical Assistance Program (Note 2)	CHS	2,647,415,374		2,899,984
		CFC	17,717,086		9,379
		OAG	108,000		
93.779	Centers for Medicare and Medicaid Services (CMS) Research, Demonstrations and Evaluations	CHS	483,578		412,244
93.917	HIV Care Formula Grants	CHS	5,896,036		4,700,591
93.919	Cooperative Agreements for State-Based Comprehensive Breast and Cervical Cancer Early Detection Programs	CHS	2,436,871		2,135,516
93.938	Cooperative Agreements to Support Comprehensive School Health Programs to Prevent the Spread of HIV and Other Important Health Problems	EDU	373,342		106,456
<b>U.S. Department of Health and Human Services (Continued)</b>					
<b>Direct Programs (Continued):</b>					
93.940	HIV Prevention Activities - Health Department Based (Note 13)	CHS	2,077,367	38,436	1,666,647
93.944	Human Immunodeficiency Virus (HIV)/Acquired Immunodeficiency Virus Syndrome (AIDS) Surveillance	CHS	126,933		85,413
93.945	Assistance Programs for Chronic Disease Prevention and Control	CHS	650,751		300,949
		EDU	401,695		321,838
93.958	Block Grants for Community Mental Health Services	CHS	5,178,274		5,171,313
		CWD	68,333		

See accompanying Notes to the Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

CFDA #	Program Title	State Organizations	Expenditures		Provided to Subrecipient
			Cash	Noncash	
93.959	Block Grants for Prevention and Treatment of Substance Abuse (Note 2)	CHS	19,213,490		18,581,135
		CORR	141,578		
		ABC	75,449		
		AOC	65,824		65,824
93.977	Preventive Health Services - Sexually Transmitted Diseases Control Grants (Note 13)	CHS	770,045	354,304	171,131
93.988	Cooperative Agreements for State-Based Diabetes Control Programs and Evaluation of Surveillance Systems	CHS	410,365		309,558
93.991	Preventive Health and Health Services Block Grant	CHS	2,401,053		2,264,727
93.994	Maternal and Child Health Services Block Grant to the States	CCHCN	4,398,632		
		CHS	8,046,928		7,994,367
NA	The Placement and Treatment of Neuropsychiatric Patients	CFC	86,281		
<b>Passed Through From the University of Kentucky:</b>					
93.241	State Rural Hospital Flexibility Program Pass Through Grantor's # - Various	EMSB	185,120		185,120
<b>Total U.S. Department of Health and Human Services</b>			<b>\$ 3,267,939,305</b>	<b>\$ 12,171,187</b>	<b>\$ 168,084,544</b>
<b><u>U.S. Corporation for National and Community Service</u></b>					
<b>Direct Programs:</b>					
94.003	State Commissions	CFC	\$ 198,415		\$
94.004	Learn and Serve America-School and Community Based Programs (Note 14)	EDU	244,134		213,278
		CFC			
94.006	AmeriCorps	CFC	2,221,872		2,176,164
94.007	Planning and Program Development Grants	CFC	7,095		
		JUV	4,637		
94.009	Training and Technical Assistance	CFC	45,012		
<b>Foster Grandparents/Senior Companion Cluster:</b>					
94.011	Foster Grandparent Program	CHS	469,388		75,442
NA	Chemical Laboratory Improvement Act	CHS	188,100		
<b>Total U.S. Corporation for National and Community Service</b>			<b>\$ 3,378,653</b>		<b>\$ 2,464,884</b>
<b><u>U.S. Office of National Drug Control Policy</u></b>					
<b>Direct Programs:</b>					
NA	High Intensity Drug Trafficking Area Program	KSP	\$ 876,628		
<b>Total U.S. Office of National Drug Control Policy</b>			<b>\$ 876,628</b>		
<b><u>U.S. Social Security Administration</u></b>					
<b>Direct Programs:</b>					
<b>Disability Insurance/SSI Cluster:</b>					
96.001	Social Security-Disability Insurance (Note 2)	CFC	\$ 37,833,963		

See accompanying Notes to the Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

CFDA #	Program Title	State Organizations	Expenditures		Provided to Subrecipient
			Cash	Noncash	
96.008	Social Security - Benefits Planning, Assistance, and Outreach Program	PUBAD	31,680		
<b>Total U.S. Social Security Administration</b>			<u>\$ 37,865,643</u>		
<b><u>Other Federal Assistance</u></b>					
<b><u>Direct Programs:</u></b>					
NA	Appalachia High Intensity Drug Trafficking Area	GOV	\$ 27,829		\$
NA	Joint Funding Administration (Note 8)	DLG	1,599,000		1,599,000
<b>Total Other Federal Assistance</b>			<u>\$ 1,626,829</u>		<u>\$ 1,599,000</u>
<b>Total All State Organizations</b>			<u>\$ 5,567,277,900</u>	<u>\$ 634,285,409</u>	<u>\$ 869,603,480</u>

See accompanying Notes to the Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF KENTUCKY**  
**NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**FOR THE YEAR ENDED JUNE 30, 2002**

**Note 1 - Purpose of the Schedule and Significant Accounting Policies**

**Basis of Presentation** - OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, requires a Schedule of Expenditures of Federal Awards showing each federal financial assistance program as identified in the *Catalog of Federal Domestic Assistance*. The accompanying schedule includes all federal grant activity for the Commonwealth, except those programs administered by state universities, and is presented primarily on the basis of cash disbursements as modified by the application of Kentucky Revised Statute (KRS) 45.229. Consequently, certain expenditures are recorded in the accounts only when cash is disbursed. The Commonwealth elected to exclude state universities from the statewide single audit, except as part of the audit of the basic financial statements.

KRS 45.229 provides that the Finance and Administration Cabinet may, “for a period of thirty (30) days after the close of any fiscal year, draw warrants against the available balances of appropriations made for that fiscal year, for the payment of expenditures incurred during that year or in fulfillment of contracts properly made during the year, but for no other purpose.” However, there is an exception to the application of KRS 45.229 in that regular payroll expenses incurred during the last pay period of the fiscal year are charged to the next year.

The basic financial statements of the Commonwealth are presented on the modified accrual basis of accounting for the governmental fund financial statements and the accrual basis of accounting for the government-wide, proprietary fund, and fiduciary fund financial statements. Therefore, the schedule may not be directly traceable to the basic financial statements in all cases.

Noncash assistance programs are not reported in the basic financial statements of the Commonwealth for FY 02. The noncash expenditures presented on this schedule represent the noncash assistance expended using the method or basis of valuation described in Note 13.

Clusters of programs are indicated in the schedule by light gray shading.

The state agencies’ schedule is presented on the cash, modified cash, or accrual basis of accounting.

**Inter-Agency Activity** - Certain transactions relating to federal financial assistance may appear in the records of more than one (1) state agency. To avoid the overstatement of federal expenditures, the following policies were adopted for the presentation of the schedule:

**COMMONWEALTH OF KENTUCKY**  
**NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**FOR THE YEAR ENDED JUNE 30, 2002**  
**(CONTINUED)**

**Note 1 - Purpose of the Schedule and Significant Accounting Policies (Continued)**

**Inter-Agency Activity (Continued)**

(a) Federal moneys may be received by a state agency and passed through to another state agency where the moneys are expended. Except for pass-throughs to state universities as discussed below, this inter-agency transfer activity is reported by the agency expending the moneys.

State agencies that pass federal funds to state universities report those amounts as expenditures.

(b) Federal moneys received by a state agency and used to purchase goods or services from another state agency are reported in the schedule as an expenditure by the purchasing agency only.

**Note 2 - Type A Programs**

Type A programs for the Commonwealth mean any program for which total expenditures of federal awards exceeded \$17 million for FY 02. The Commonwealth had the following programs (cash and noncash) that met the Type A program definition for FY 02, some of which were administered by more than one (1) state agency. Certain component units and agencies audited by certified public accounting firms had lower dollar thresholds. The Commonwealth identified clusters among the Type A programs by gray shading. These Type A programs and clusters were:

<b>CFDA #</b>	<b>Program Title</b>	<b>Expenditures</b>
<b>Food Stamp Cluster:</b>		
<b>10.551</b>	Food Stamps	\$ 393,743,563
<b>10.561</b>	State Administrative Matching Grants for Food Stamp Program	25,886,143
<b>Child Nutrition Cluster:</b>		
<b>10.553</b>	School Breakfast Program	32,797,178
<b>10.555</b>	National School Lunch Program	101,372,269
<b>10.556</b>	Special Milk Program for Children	105,684
<b>10.559</b>	Summer Food Service Program for Children	4,113,897
<b>10.557</b>	Special Supplemental Nutrition Program for Women, Infants, and Children	82,607,353
<b>10.558</b>	Child and Adult Care Food Program	24,738,134
<b>10.766</b>	Community Facilities Loans and Grants	66,566,478

**COMMONWEALTH OF KENTUCKY**  
**NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**FOR THE YEAR ENDED JUNE 30, 2002**  
**(CONTINUED)**

**Note 2 - Type A Programs (Continued)**

<b>CFDA #</b>	<b>Program Title</b>	<b>Expenditures</b>
<b>11.550</b>	Public Telecommunications Facilities-Planning and Construction	266,894
<b>14.117</b>	Mortgage Insurance – Homes	128,011,580
<b>Section 8 Project-Based Cluster:</b>		
<b>14.182</b>	Lower Income Housing Assistance Program – Section 8 New Construction/Substantial Rehabilitation	86,146,058
<b>14.856</b>	Lower Income Housing Assistance Program – Section 8 Moderate Rehabilitation	468,566
<b>14.228</b>	Community Development Block Grants/State’s Program	41,356,553
<b>14.235</b>	Supportive Housing Program	3,302,310
<b>14.239</b>	HOME Investment Partnerships Program	20,004,568
<b>14.871</b>	Section 8 Housing Choice Vouchers	15,425,269
<b>15.252</b>	Abandoned Mine Land Reclamation (AMLR) Program	19,835,610
<b>17.225</b>	Unemployment Insurance	570,264,827
<b>17.255</b>	Workforce Investment Act	21,609,832
<b>Workforce Investment Act Cluster:</b>		
<b>17.258</b>	WIA Adult Program	13,241,025
<b>17.259</b>	WIA Youth Activities	4,709,153
<b>17.260</b>	WIA Dislocated Workers	11,450,753
<b>Highway Planning and Construction Cluster:</b>		
<b>20.205</b>	Highway Planning and Construction	522,066,210
<b>64.114</b>	Veterans Housing-Guaranteed and Insured Loans	9,324,960
<b>66.458</b>	Capitalization Grants for State Revolving Funds	10,007,125
<b>66.468</b>	Capitalization Grants for Drinking Water State Revolving Funds	18,014,792
<b>84.010</b>	Title I Grants to Local Educational Agencies	130,211,327
<b>Special Education Cluster:</b>		
<b>84.027</b>	Special Education - Grants to States	78,960,489
<b>84.173</b>	Special Education – Preschool Grants	10,392,278

**COMMONWEALTH OF KENTUCKY**  
**NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**FOR THE YEAR ENDED JUNE 30, 2002**  
**(CONTINUED)**

**Note 2 - Type A Programs (Continued)**

<b>CFDA #</b>	<b>Program Title</b>	<b>Expenditures</b>
<b>Student Financial Assistance Program Cluster:</b>		
<b>84.032</b>	Federal Family Education Loans	60,537,247
<b>84.126</b>	Rehabilitation Services – Vocational Rehabilitation Grants to States	42,906,886
<b>84.281</b>	Eisenhower Professional Development State Grants	702,952
<b>84.334</b>	Gaining Early Awareness and Readiness for Undergraduate Programs	2,047,561
<b>84.340</b>	Class Size Reduction	23,299,389
<b>93.558</b>	Temporary Assistance for Needy Families	195,364,234
<b>93.563</b>	Child Support Enforcement	43,302,819
<b>93.568</b>	Low-Income Home Energy Assistance	23,013,626
<b>Child Care Cluster:</b>		
<b>93.575</b>	Child Care and Development Block Grant	16,236,252
<b>93.596</b>	Child Care Mandatory and Matching Funds of the Child Care and Development Fund	53,109,779
<b>93.658</b>	Foster Care-Title IV-E	50,164,995
<b>93.667</b>	Social Services Block Grant	22,353,854
<b>93.767</b>	State Children’s Insurance Program	60,762,233
<b>Medicaid Cluster:</b>		
<b>93.775</b>	State Medicaid Fraud Control Units	1,044,574
<b>93.777</b>	State Survey and Certification of Health Care Providers and Suppliers	5,206,307
<b>93.778</b>	Medical Assistance Program	2,665,240,460
<b>93.959</b>	Block Grants for Prevention and Treatment of Substance Abuse	19,496,341
<b>Disability Insurance/SSI Cluster:</b>		
<b>96.001</b>	Social Security – Disability Insurance	37,833,963
<b>Total Type A Programs</b>		<b>\$ 5,769,624,350</b>

**COMMONWEALTH OF KENTUCKY  
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**Note 3 - Federally Assisted Loan Programs**

The Commonwealth has several loan programs made possible with initial advances in prior years from the federal government. In addition, the federal government guarantees some loan programs.

a) The Kentucky Rural Rehabilitation Student Loan Program was initially awarded \$672,629 in 1970 by the U. S. Farmers Home Administration. Since 1970, the program has operated on interest from student loans outstanding and on income from investments administered by the Office of Financial Management. The Department of Agriculture is no longer in the business of making student loans and reassigned all loans in payment compliance to the Kentucky Higher Education Assistance Authority (KHEAA). The Department of Agriculture retained only those loans that had a delinquent payment history. This program is currently in phase-out status, with authorization from the U.S. Department of Agriculture (USDA) to eliminate the principal through issuance of specific grants and scholarships. Most outstanding loans have been classified as contingent uncollectible liabilities. When loan payments are received, they are directly deposited into the principal account. The total amount of money in the investment account as of June 30, 2002 was \$859,073. Student loans and investments earned interest of \$52,935. Outstanding student loans totaled \$64,536. The total grants and scholarships authorized by the USDA in FY 02 totaled \$107,993.

b) Total moneys for the Gas System Restoration Project, administered by the Department for Local Government (CFDA #11.307), consist of \$3,150,000 from the U.S. Economic Development Administration; \$500,000 from the U.S. Appalachian Regional Commission; and, \$650,000 in state matching money, for a total commitment to the revolving loan program of \$4,300,000. All monies had been received and paid out by June 30, 2002. In addition, principal and interest repaid is available for lending.

c) The Kentucky Higher Education Student Loan Corporation (KHESLC) issues revenue bonds to purchase student loans authorized under the Federal Family Education Loans program (CFDA #84.032). KHEAA guarantees substantially all loans made and purchased by KHESLC. The U.S. Department of Education provides for reinsurance of loans guaranteed by KHEAA. Outstanding loans guaranteed under this program totaled \$2,336,677,000 as of June 30, 2002.

d) The Kentucky Infrastructure Authority administers wastewater revolving loan programs (CFDA #66.458 and 66.468) funded by the U.S. Environmental Protection Agency's Capitalization Grants for State Revolving Funds. During FY 02, the Kentucky Infrastructure Authority issued loans totaling \$26,017,690, with outstanding loans of \$236,004,657 at year-end.

**COMMONWEALTH OF KENTUCKY**  
**NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**FOR THE YEAR ENDED JUNE 30, 2002**  
**(CONTINUED)**

**Note 3 - Federally Assisted Loan Programs (Continued)**

e) The Department of Housing and Urban Development's Mortgage Insurance-Homes Program (CFDA #14.117), Department of Agriculture's Rural Housing Service Community Facilities Loans and Grants (CFDA #10.766), and Department of Veterans Affairs' Veterans Housing - Guaranteed and Insured Loans (CFDA #64.114) represent the loans originated in FY 02 by the Kentucky Housing Corporation. The cumulative outstanding balance of the Mortgage Insurance Program, Rural Housing Service Community Facilities Loans and Grants Program, and Veterans Housing and Guaranteed Loans Program loans originated by the Kentucky Housing Corporation is \$631,007,822, \$245,155,464, and \$61,934,945, respectively at June 30, 2002.

**Note 4 - Activity Occurring in Programs with Inventoriable Items**

The Department of Agriculture operates a warehouse in Louisville, Kentucky for the Commodity Supplemental Food Program (CFDA #10.565). The dollar value of the inventory, based on the USDA Commodity File dated May 2002, is as follows:

	<b>Commodity Supplemental Food Program CFDA #10.565</b>
Beginning Inventory, July 1, 2001	\$ 626,521
Received	1,388,537
Issued to Recipients	(1,447,520)
Ending Inventory, June 30, 2002	\$ 567,538

**Note 5 - Unemployment Insurance (CFDA #17.225)**

The Commonwealth paid out \$543,666,531 in benefits in FY 02. The amounts shown on the accompanying schedule reflect both the amount expended for benefits from the Trust Fund and an additional \$26,598,296 of federal funds expended for administration of the program, resulting in a combined total of \$570,264,827 in federal expenditures.

**Note 6 - Highway Planning and Construction (CFDA #20.205)**

The information reported for this program represents the activity of all open projects during FY 02. These projects were funded from several apportionments. Apportionments refer to a federal, statutorily prescribed division or assignment of funds. The expenditures reflected on the schedule include expenditures for advance construction projects, which are not yet under agreements with the Federal Highway Administration (FHWA).

**COMMONWEALTH OF KENTUCKY**  
**NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**FOR THE YEAR ENDED JUNE 30, 2002**  
**(CONTINUED)**

**Note 6 - Highway Planning and Construction (CFDA #20.205) (Continued)**

Program Income - The Highway Planning and Construction Program earned program income of \$427,652 in FY 02. This income was earned in the right-of-way phase through the sale and rental of real property. Income earned in this manner was classified as a negative expenditure, resulting in a reduction to federal expenditures for the current year.

Refunds - Expenditures for the Highway Planning and Construction Program were shown net of any refunds, resulting from a reimbursement of prior or current year expenditures. Refunds totaled \$4,226,953 for FY 02.

**Note 7 - Outdoor Recreation - Acquisition, Development and Planning (CFDA # 15.916) and Recreational Trails Program (CFDA # 20.219)**

Administrative costs are shown as expended when received from the federal government. These costs are recovered through a negotiated fixed-indirect cost rate. Any over or under recovery will be recouped in the future.

**Note 8 - Joint Funding Administration**

The Joint Funding Administration Program (listed in the schedule under Other Federal Assistance) consists of grants from the following federal agencies:

- U.S. Department of Commerce
- U.S. Department of Housing and Urban Development
- U.S. Appalachian Regional Commission

**Note 9 - Research and Development Expenditures**

OMB Circular A-133 Section 105 states, "Research and development (R&D) means all research activities, both basic and applied, and all development activities that are performed by a non-federal entity."

The expenditures presented in the SEFA include R&D expenditures. The R&D portion of the expenditures for each program is listed below.

<b>CFDA #</b>	<b>Program Title</b>	<b>State Organization</b>	<b>Expenditures</b>
15.605	Sport Fish Restoration	F&W	\$ 1,248,749
15.611	Wildlife Restoration	F&W	44,798
15.615	Cooperative Endangered Species Conservation Fund	F&W	21,552
15.617	Wildlife Conservation and Appreciation	F&W	11,382

**COMMONWEALTH OF KENTUCKY  
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**Note 9 - Research and Development Expenditures (Continued)**

<b>CFDA #</b>	<b>Program Title</b>	<b>State Organization</b>	<b>Expenditures</b>
15.625	Wildlife Conservation and Restoration	F&W	77,960
15.810	National Cooperative Geologic Mapping Program	F&W	119,969
NA	National Fish and Wildlife Foundation- Restoration of Elk Habitat in Kentucky	F&W	21,822
16.585	Drug Court Discretionary Grant Program	AOC	136,046
23.011	Appalachian State Research, Technical Assistance, and Demonstration Projects	GOV	100,000
93.230	Consolidated Knowledge Development and Application (KD&A) Program	CHS	390,817
93.238	Cooperative Agreements for State Treatment Outcomes and Performance Pilot Studies Enhancement	CHS	228,119
<b>Total R&amp;D Expenditures</b>			<b>\$ 2,401,214</b>

**Note 10 - Community Development Block Grants/State's Program (CFDA #14.228)**

The Commonwealth matches the federal portion of administration dollar for dollar. Cash expenditures include the federal portion of administration.

**Note 11 - Wildlife Restoration (CFDA #15.611)**

The Department of Fish and Wildlife Resources leases properties from the U.S. Army Corps of Engineers for Condition Three and Condition Five Projects. These projects stipulate that the properties leased be managed for wildlife purposes and may produce income. The leases for wildlife management rights on these properties are non-monetary. The Department of Fish and Wildlife Resources currently leases the following properties:

- Barlow Bottoms-Olmstead
- Barren River
- Birdsville Island
- Green River
- Dewey Lake
- Fishtrap Lake
- Lake Cumberland
- Paintsville Lake
- Sloughs-Grassy Pond

**COMMONWEALTH OF KENTUCKY**  
**NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**FOR THE YEAR ENDED JUNE 30, 2002**  
**(CONTINUED)**

**Note 11 - Wildlife Restoration (CFDA #15.611) (Continued)**

Any expenditure in excess of revenue from each property listed will be eligible for reimbursement under the Wildlife Restoration grant (CFDA #15.611) from the U.S. Department of the Interior. The properties listed above are not reimbursed with federal funds, if the grant has already been expended to manage other wildlife properties.

**Note 12 - Workforce Investment Act (CFDA #17.255)**

The Workforce Investment Act program (CFDA #17.255) includes expenditures from the Employment and Training Assistance-Dislocated Workers (CFDA #17.246) in the amount of \$165,139 and the Job Training Partnership Act (CFDA #17.250) in the amount of \$16,364,028. When combined with the federal expenditures for CFDA #17.255 of \$5,080,665, the total is \$21,609,832. Since these programs have become part of CFDA #17.255, all expenditures are reported in the schedule under CFDA #17.255.

**Note 13 - Noncash Expenditure Programs**

The Commonwealth's noncash programs and a description of the method/basis of valuation follow.

<b>CFDA #</b>	<b>Program Title</b>	<b>Amount</b>	<b>Method/Basis of Valuation</b>
10.550	Food Donation	\$ 15,398,038	USDA's value at the time of delivery to recipient agencies.
10.551	Food Stamps	393,743,563	Electronic Benefit Transfer Issuance.
10.565	Commodity Supplemental Food Program	1,447,520	Quantity issued to recipients valued at USDA's May 2002 prices.
10.569	Emergency Food Assistance Program (Food Commodities)	6,081,856	Quantity issued to recipients valued at USDA's May 2002 prices.
10.766	Community Facilities Loans and Grants	66,566,478	Book value of loans.
10.914	Wildlife Habitat Incentive Program	21,000	Office space (office supplies and telephone).

**COMMONWEALTH OF KENTUCKY  
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**Note 13 - Noncash Expenditure Programs (Continued)**

<b>CFDA #</b>	<b>Program Title</b>	<b>Amount</b>	<b>Method/Basis of Valuation</b>
NA	Natural Resources Soil Conservation Program	30,455	Assistance in paying the amount of salary in excess of \$12,255 for Interagency Personnel Agreement position.
14.117	Mortgage Insurance-Homes	128,011,580	Book value of loans.
15.250	Regulation of Surface Coal Mining and Surface Effects of Underground Coal Mining	50,372	Inventory of property.
15.252	Abandoned Mine Land Reclamation (AMLR) Program	40,600	Matched project costs.
15.808	U.S. Geological Survey - Research and Data Acquisition	209,767	Split costs for investigation and network operations.
NA	Water Investigation at Maxey Flats	58,500	Match portion of the state contribution spent by the state to continue water investigation.
39.003	Donation of Federal Surplus Personal Property	799,538	23.3% of federal acquisition cost (\$3,431,495).
64.114	Veterans Housing - Guaranteed and Insured Loans	9,324,960	Book value of loans.
66.001	Air Pollution Control Program Support	30,000	U.S. Environmental Protection Agency (EPA) in-kind contribution.
66.463	Water Quality Cooperative Agreements	60,000	EPA in-kind contribution.
66.606	Surveys, Studies, Investigations and Special Purpose Grants	190,710	EPA in-kind contribution.

**COMMONWEALTH OF KENTUCKY  
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**Note 13 - Noncash Expenditure Programs (Continued)**

<b>CFDA #</b>	<b>Program Title</b>	<b>Amount</b>	<b>Method/Basis of Valuation</b>
66.709	Capacity Building Grants and Cooperative Agreements for States and Tribes	49,285	Amount paid by EPA to contractor on behalf of this program.
93.116	Project Grants and Cooperative Agreements for Tuberculosis Control Programs	80,905	Per authorized award for personnel costs and travel.
93.268	Immunization Grants	11,697,542	Per authorized award for personnel, vaccine costs, and travel.
93.940	HIV Prevention Activities - Health Department Based	38,436	Per authorized personnel costs.
93.977	Preventive Health Services - Sexually Transmitted Diseases Control Grants	354,304	Per authorized personnel costs and travel.
<b>Total Noncash Expenditures</b>		<u>\$ 634,285,409</u>	

**Note 14 - Zero Expenditure Programs**

These programs had no expenditures related to the respective state organization during FY 02. The zero expenditure programs included programs with no activity during the year, such as old programs not officially closed out or new programs issued late in the fiscal year. They also included programs with activity other than expenditures. For CFDA numbers with multiple state organizations listed, the schedule is presented in descending expenditure amount order.

**Note 15 - Noncompliance Item - Highway Planning and Construction (CFDA #20.205)**

The Transportation Cabinet has been informed by the Kentucky Office of Federal Highway Administration that its method of charging certain costs to federal programs is in violation of OMB Circular A-87. These costs involve charges that could possibly be classified as indirect costs. The Transportation Cabinet has implemented changes in their accounting procedures to eliminate these type charges from the federal billing.

## **REPORTS ON COMPLIANCE AND ON INTERNAL CONTROL**



EDWARD B. HATCHETT, JR.  
AUDITOR OF PUBLIC ACCOUNTS

Report on Compliance and on Internal Control Over Financial Reporting  
Based on an Audit of Financial Statements  
Performed in Accordance With  
*Government Auditing Standards*

To the People of Kentucky  
Honorable Paul E. Patton, Governor  
Gordon C. Duke, Secretary  
Finance and Administration Cabinet

We have audited the basic financial statements of the Commonwealth of Kentucky as of and for the year ended June 30, 2002, and have issued our report thereon dated December 20, 2002. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Several agencies were tested for compliance and internal control requirements in accordance with *Government Auditing Standards* by other auditors, whose reports thereon have been furnished to us. However, the audit reports for Western Kentucky University and the Kentucky Center for the Arts have not been released as of the date of this report and therefore those financial statements have not been audited.

Compliance

As part of obtaining reasonable assurance about whether the Commonwealth's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings and Questioned Costs as items 02-KAP1-1, 02-FAC1-4, 02-CPE3-26, 02-CPE4-27, 02-CPE5-28, 02-CPE6-29, and 02-CPE7-30. We also noted certain immaterial instances of noncompliance, which we have reported to management.



Report on Compliance and on Internal Control Over  
Financial Reporting Based on an Audit of  
Financial Statements Performed in Accordance  
With *Government Auditing Standards*  
(Continued)

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Commonwealth's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Commonwealth's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items 02-CFC1-2, 02-CFC2-3, 02-FAC2-5, 02-FAC3-6, 02-FAC4-7, 02-FAC5-8, 02-FAC6-9, 02-FAC7-10, 02-FAC8-11, 02-FAC9-12, 02-CHS1-13, 01-CHS2-14, 02-CHS3-15, 02-PERS1-16, 02-REV1-17, 02-REV2-18, 02-REV4-19, 02-REV5-20, 02-REV6-21, 02-REV3-31, 02-KST1-22, 02-CWD1-23, 02-CWD3-24, 02-CWD4-25, and 02-CWD2-32.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider items 02-REV3-31 and 02-CWD2-32 to be material weaknesses. We also noted other matters involving the internal control over financial reporting, which we have reported to management.

Report on Compliance and on Internal Control Over  
Financial Reporting Based on an Audit of  
Financial Statements Performed in Accordance  
With *Government Auditing Standards*  
(Continued)

This report is intended solely for the information and use of management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Sincerely,

A handwritten signature in black ink, appearing to read "Ed Hatchett", with a stylized flourish at the end.

Edward B. Hatchett, Jr.  
Auditor of Public Accounts

December 20, 2002





EDWARD B. HATCHETT, JR.  
AUDITOR OF PUBLIC ACCOUNTS

Report on Compliance With Requirements Applicable to Each  
Major Program and on Internal Control Over Compliance in  
Accordance With OMB Circular A-133 and on the  
Schedule of Expenditures of Federal Awards

To the People of Kentucky  
Honorable Paul E. Patton, Governor  
Gordon C. Duke, Secretary  
Finance and Administration Cabinet

Compliance

We have audited the compliance of the Commonwealth of Kentucky with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2002. The Commonwealth's major federal programs are identified in the Summary of Auditor's Results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the Commonwealth's management. Our responsibility is to express an opinion on the Commonwealth's compliance based on our audit.

Several agencies were audited for compliance requirements in accordance with OMB Circular A-133 by other auditors, whose reports thereon have been furnished to us, and our opinion presented herein, insofar as it relates to these agencies listed in Appendix 1 to this report, is based on the reports of the other auditors. However, the OMB Circular A-133 audit report for the Kentucky Center for the Arts has not been released as of the date of this report and therefore those federal expenditures have not been audited.

The Commonwealth's basic financial statements included the operations of the state universities, which expended \$414,744,724 in federal awards that are not included in the Schedule of Expenditures of Federal Awards for the year ended June 30, 2002. The expenditure amount for the University of Louisville was not available and no expenditures relating to them have been included in the above amount. Our audit, described below, did not include the operations of the state universities because they engaged other auditors to perform an audit in accordance with OMB Circular A-133.



Report on Compliance With Requirements Applicable to Each  
Major Program and on Internal Control Over Compliance in  
Accordance With OMB Circular A-133 and on the  
Schedule of Expenditures of Federal Awards  
(Continued)

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Commonwealth's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Commonwealth's compliance with those requirements.

In our opinion, based on our audit and the reports of other auditors, the Commonwealth complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2002. The results of our auditing procedures also disclosed instances of noncompliance with those requirements that are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying Schedule of Findings and Questioned Costs as items 02-CFC14-34, 02-CFC15-35, 02-CHS14-38, 02-JUST1-39, 02-JUST2-40, 02-JUST3-41, 02-JUST4-42, 02-MIL1-43, 02-CPE1-44, 02-CPE2-45, 02-TC3-47, 02-TC4-48, and 02-TC5-49.

Internal Control Over Compliance

The management of the Commonwealth is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Commonwealth's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

Report on Compliance With Requirements Applicable to Each  
Major Program and on Internal Control Over Compliance in  
Accordance With OMB Circular A-133 and on the  
Schedule of Expenditures of Federal Awards  
(Continued)

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the Commonwealth's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items 02-CFC12-33, 02-CFC14-34, 02-CFC15-35, 02-CHS12-36, 02-CHS13-37, 02-CHS14-38, 02-JUST1-39, 02-JUST2-40, 02-JUST3-41, 02-JUST4-42, 02-MIL1-43, 02-TC2-46, 02-CWD11-50, 02-CWD12-51, 02-CWD13-52, and 02-CWD14-53.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness. We also noted other matters involving internal control over compliance which we have communicated to management.

Schedule of Expenditures of Federal Awards

We have audited the basic financial statements of the Commonwealth as of and for the year ended June 30, 2002, and have issued our report thereon dated December 20, 2002. Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements taken as a whole.

Report on Compliance With Requirements Applicable to Each  
Major Program and on Internal Control Over Compliance in  
Accordance With OMB Circular A-133 and on the  
Schedule of Expenditures of Federal Awards  
(Continued)

Several Schedules of Expenditures of Federal Awards were audited by other auditors, whose reports thereon have been furnished to us, and our opinion presented herein, insofar as it relates to these agencies listed in Appendix 1 to this report, is based on the reports of the other auditors. However, the OMB Circular A-133 audit report for the Kentucky Center for the Arts has not been released as of the date of this report and therefore those federal expenditures have not been audited. The Kentucky Center for the Arts federal expenditures are included in the Schedule of Expenditures of Federal Awards.

The basic financial statements of the Commonwealth are prepared on an accrual/modified accrual basis of accounting. However, the Schedule of Expenditures of Federal Awards of the Commonwealth is prepared on the basis of cash disbursements as modified by the application of KRS 45.229. Consequently, certain expenditures are recorded in the accounts only when cash is disbursed. Accordingly, the Schedule of Expenditures of Federal Awards is not intended to present the expenditures of federal awards in conformity with accounting principles generally accepted in the United States of America.

In our opinion, based on our audit and the reports of other auditors, except for the effect of the application of a different basis of accounting as explained above, the Schedule of Expenditures of Federal Awards is fairly stated, in all material respects, in relation to the Commonwealth's basic financial statements taken as a whole.

This report is intended solely for the information and use of management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Sincerely,

A handwritten signature in black ink, appearing to read "Ed Hatchett", with a stylized flourish at the end.

Edward B. Hatchett, Jr.  
Auditor of Public Accounts

Schedule of Expenditures of Federal Awards  
December 20, 2002

March 17, 2003

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002**

**SECTION 1 – SUMMARY OF AUDITOR’S RESULTS**

**Financial Statement Accounts**

Financial Statement Accounts: We issued an unqualified opinion on the basic financial statements of the Commonwealth for the year ended June 30, 2002.

Compliance: In relation to the audit of the basic financial statements of the Commonwealth, and the Schedule of Expenditures of Federal Awards, the results of our tests disclosed seven (7) instances of noncompliance that are required to be reported under *Government Auditing Standards*. We believe five (5) of the instances of noncompliance are material.

<u>STATE ORGANIZATION</u>	<u>REPORTABLE</u>	<u>MATERIAL</u>
Kentucky Access Program (02-KAP1-1)	1	
Finance and Administration Cabinet (02-FAC1-4)	1	
Council on Postsecondary Education (02-CPE3-26, 02-CPE4-27, 02-CPE5-28, 02-CPE6-29, and 02-CPE7-30)		5

Internal Control Over Financial Reporting: Our consideration of the Commonwealth’s internal control over financial reporting disclosed 25 reportable conditions. We believe two (2) of the reportable conditions are material weaknesses. The reportable conditions, which were disclosed during our audit, are applicable to the following state organizations:

<u>STATE ORGANIZATION</u>	<u>REPORTABLE</u>	<u>MATERIAL</u>
Cabinet for Families and Children (02-CFC1-2 and 02-CFC2-3)	2	
Finance and Administration Cabinet (02-FAC2-5, 02-FAC3-6, 02-FAC4-7, 02-FAC5-8, 02-FAC6-9, 02-FAC7-10, 02-FAC8-11, and 02-FAC9-12)	8	
Cabinet for Health Services (02-CHS1-13, 02-CHS2-14, and 02-CHS3-15)	3	

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 1 – SUMMARY OF AUDITOR’S RESULTS (CONTINUED)**

**Financial Statement Accounts (Continued)**

<u>STATE ORGANIZATION</u>	<u>REPORTABLE</u>	<u>MATERIAL</u>
Personnel Cabinet (02-PERS1-16)	1	
Revenue Cabinet (02-REV1-17, 02-REV2-18, 02-REV4-19, 02-REV5-20, 02-REV6-21, and 02-REV3-31)	5	1
Office of the Kentucky State Treasurer (02-KST1-22)	1	
Cabinet for Workforce Development (02-CWD1-23, 02-CWD3-24, 02-CWD4-25, and 02-CWD2-32)	3	1

**Federal Awards and Schedule of Expenditures of Federal Awards**

Compliance: We issued an unqualified opinion on the Commonwealth’s compliance with the requirements applicable to each of its major federal programs. However, the results of our auditing procedures disclosed 13 instances of noncompliance, which are required to be reported in accordance with OMB Circular A-133. We believe none of the instances of noncompliance are material.

<u>STATE ORGANIZATION</u>	<u>REPORTABLE</u>	<u>MATERIAL</u>
Cabinet for Families and Children (02-CFC14-34 and 02-CFC15-35)	2	
Cabinet for Health Services (02-CHS14-38)	1	
Justice Cabinet-Office of the Secretary (02-JUST1-39, 02-JUST2-40, 02-JUST3-41, and 02-JUST4-42)	4	
Department of Military Affairs (02-MIL1-43)	1	
Council on Postsecondary Education (02-CPE1-44 and 02-CPE2-45)	2	
Transportation Cabinet (02-TC3-47, 02-TC4-48, and 02-TC5-49)	3	

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 1 – SUMMARY OF AUDITOR’S RESULTS (CONTINUED)**

**Federal Awards and Schedule of Expenditures of Federal Awards (Continued)**

Internal Control Over Compliance: Our consideration of the Commonwealth’s internal control over compliance disclosed 16 reportable conditions. We believe that none of the reportable conditions are material weaknesses. The reportable conditions, which were disclosed during our audit, are applicable to the following state organizations:

<u>STATE ORGANIZATION</u>	<u>REPORTABLE</u>	<u>MATERIAL</u>
Cabinet for Families and Children (02-CFC12-33, 02-CFC14-34, and 02-CFC15-35)	3	
Cabinet for Health Services (02-CHS12-36, 02-CHS13-37, and 02-CHS14-38)	3	
Justice Cabinet-Office of the Secretary (02-JUST1-39, 02-JUST2-40, 02-JUST3-41, and 02-JUST4-42)	4	
Department of Military Affairs (02-MIL1-43)	1	
Transportation Cabinet (02-TC2-46)	1	
Cabinet for Workforce Development (02-CWD11-50, 02-CWD12-51, 02-CWD13-52, and 02-CWD14-53)	4	

Schedule of Expenditures of Federal Awards: We issued a qualified opinion on the Commonwealth’s Schedule of Expenditures of Federal Awards because of the effect of the application of a different basis of accounting that is not in conformity with accounting principles generally accepted in the United States of America as described in Note 1 of the schedule. The opinion was issued in relation to the basic financial statements of the Commonwealth taken as a whole.

**Identification of Major Programs Audited**

Based on OMB Circular A-133, the following is a list of major Type A programs audited:

<u>CFDA #</u>	<u>Program Title</u>	<u>Expenditures</u>
<b>Food Stamp Cluster:</b>		
<b>10.551</b>	Food Stamps	\$ 393,743,563
<b>10.561</b>	State Administrative Matching Grants for Food Stamp Program	25,362,111

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 1 – SUMMARY OF AUDITOR’S RESULTS (CONTINUED)**

**Identification of Major Programs Audited (Continued)**

<b>CFDA #</b>	<b>Program Title</b>	<b>Expenditures</b>
<b>10.766</b>	Community Facilities Loans and Grants	66,566,478
<b>11.550</b>	Public Telecommunications – Planning and Construction	266,894
<b>14.117</b>	Mortgage Insurance-Homes	128,011,580
<b>Section 8 Project-Based Cluster:</b>		
<b>14.182</b>	Lower Income Housing Assistance Program – Section 8 New Construction/Substantial Rehabilitation	86,146,058
<b>14.856</b>	Lower Income Housing Assistance Program – Section 8 Moderate Rehabilitation	468,566
<b>14.235</b>	Supportive Housing Program	3,302,310
<b>14.239</b>	HOME Investment Partnerships Program	20,004,568
<b>14.871</b>	Section 8 Housing Choice Vouchers	15,425,269
<b>17.225</b>	Unemployment Insurance	570,264,827
<b>17.255</b>	Workforce Investment Act	21,609,832
<b>Workforce Investment Act Cluster:</b>		
<b>17.258</b>	WIA Adult Program	13,241,025
<b>17.259</b>	WIA Youth Activities	3,999,874
<b>17.260</b>	WIA Dislocated Workers	11,450,753
<b>Highway Planning and Construction Cluster:</b>		
<b>20.205</b>	Highway Planning and Construction	522,066,210
<b>64.114</b>	Veterans Housing-Guaranteed and Insured Loans	9,324,960
<b>66.458</b>	Capitalization Grants for State Revolving Funds	10,007,125
<b>66.468</b>	Capitalization Grants for Drinking Water State Revolving Funds	16,807,935
<b>Student Financial Assistance Programs Cluster:</b>		
<b>84.032</b>	Federal Family Education Loans	60,537,247
<b>84.069</b>	Leveraging Educational Assistance Partnership	753,617

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 1 – SUMMARY OF AUDITOR’S RESULTS (CONTINUED)**

**Identification of Major Programs Audited (Continued)**

<b>CFDA #</b>	<b>Program Title</b>	<b>Expenditures</b>
<b>84.126</b>	Rehabilitation Services – Vocational Rehabilitation Grants to States	42,904,112
<b>84.281</b>	Eisenhower Professional Development State Grants	702,952
<b>84.334</b>	Gaining Early Awareness and Readiness for Undergraduate Programs	2,047,561
<b>93.558</b>	Temporary Assistance for Needy Families	188,712,921
<b>93.563</b>	Child Support Enforcement	43,140,200
<b>93.568</b>	Low-Income Home Energy Assistance	22,998,589
<b>Child Care Cluster:</b>		
<b>93.575</b>	Child Care and Development Block Grant	16,236,252
<b>93.596</b>	Child Care Mandatory and Matching Funds of the Child Care and Development Fund	50,781,166
<b>93.767</b>	State Children’s Insurance Program	59,841,382
<b>Medicaid Cluster:</b>		
<b>93.775</b>	State Medicaid Fraud Control Units	1,044,574
<b>93.777</b>	State Survey and Certification of Health Care Providers and Suppliers	5,206,307
<b>93.778</b>	Medical Assistance Program	2,647,415,374
<b>93.959</b>	Block Grants for the Prevention and Treatment of Substance Abuse	19,213,490
Total Type A Programs Audited		<u>\$ 5,079,605,682</u>

The following is a list of Type B programs audited as major programs:

<b>CFDA #</b>	<b>Program Title</b>	<b>Expenditures</b>
<b>10.550</b>	Food Donation	\$ 15,398,038
<b>12.401</b>	National Guard Military Operations and Maintenance (O & M) Projects	8,377,033
<b>16.575</b>	Crime Victim Assistance	5,009,885
<b>16.579</b>	Byrne Formula Grant Program	3,673,905

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 1 – SUMMARY OF AUDITOR’S RESULTS (CONTINUED)**

**Identification of Major Programs Audited (Continued)**

<b>CFDA #</b>	<b>Program Title</b>	<b>Expenditures</b>
<b>16.588</b>	Violence Against Women Formula Grants	1,667,791
<b>17.253</b>	Welfare-to-Work Grants to States and Localities	1,931,493
<b>83.543</b>	Individual and Family Grants	4,542,103
<b>83.544</b>	Public Assistance Grants	5,278,121
<b>83.549</b>	Chemical Stockpile Emergency Preparedness Program	4,369,296
<b>84.048</b>	Vocational Education – Basic Grants to States	8,336,140
<b>Aging Cluster:</b>		
<b>93.044</b>	Special Programs for the Aging – Title III, Part B – Grants for Supportive Services and Senior Centers	4,970,611
<b>93.045</b>	Special Programs for the Aging – Title III, Part C – Nutrition Services	7,327,533
Total Type B Programs Audited		<u>\$ 70,881,949</u>
Total Major Programs Audited		<u>\$ 5,150,487,631</u>

**Dollar Threshold Used to Distinguish Between Type A and Type B Programs**

The maximum dollar threshold used to distinguish between Type A and Type B Programs was \$17 million. Certain component units and agencies audited by Certified Public Accounting (CPA) firms had lower dollar thresholds.

**Auditee Risk**

The Commonwealth did not qualify as a low-risk auditee.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

***Reportable Conditions Relating to Internal Controls and/or Reportable  
Instances of Noncompliance:***

**FINDING 02-KAP1-1: The Kentucky Access Program Should Ensure The  
Operating Account Is Properly Collateralized**

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State Organization: Kentucky Access Program

During our audit, we found that the operating account was not properly collateralized. Kentucky Access had a written Collateral Security Agreement with the bank. However, the bank had only \$99,332 pledged in addition to the Federal Deposit Insurance Corporation insurance of \$100,000. At June 30, 2002, the balance of the operating account was \$208,437.

KRS 41.240 states that before any bank shall be named as a state depository to receive public funds, it shall either pledge or provide to the State Treasurer, as collateral, securities or other obligations which have an aggregate current face value or current quoted market value at least equal to the deposits or provide to the State Treasurer a surety bond or surety bonds in favor of the State Treasurer in an amount at least equal to the deposits.

**Recommendation**

We recommend Kentucky Access monitor the pledged securities maintained by the bank to ensure that they are at least equal to the deposits.

**Management's Response and Corrective Action Plan**

*In the compliance section of its December 6, 2002 audit report, Tichenor & Associates comments on the value of the securities listed by Farmer's Bank in Exhibit A of the Collateral Security Agreement (the "Agreement") between Kentucky Access and the bank. (The Agreement between Kentucky Access and the bank is a standard agreement developed by the Auditor of Public Accounts for use by state agencies.) The Tichenor firm suggests that \$9,105 of the \$208,437 in the Kentucky Access operating account on June 30, 2002 "was not properly collateralized" by the bank pursuant to KRS 41.240 (the Public Funds Law). The Tichenor firm recommends that Kentucky Access "monitor the pledged securities maintained by the bank to ensure that they at least equal the deposits."*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-KAP1-1: The Kentucky Access Program Should Ensure The  
Operating Account Is Properly Collateralized (Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

*All duties set forth in KRS 41.240-and hence all statutory responsibilities for ensuring proper collateralization-reside entirely with the bank. Kentucky Access expresses no opinion here as to whether the bank adequately met its statutory responsibilities. Kentucky Access simply notes that any statutory non-compliance, if it exists, is not attributable to Kentucky Access.*

*Kentucky Access thinks the Tichenor firm's recommendation concerning the periodic monitoring of listed securities is reasonable. Kentucky Access has already reviewed its average daily balances and has requested that the bank amend Exhibit A to the Agreement. The bank has responded by revising Exhibit A so as to list securities valued at approximately \$1,000,000.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-CFC1-2: The Cabinet For Families And Children Should Strengthen Security Surrounding Administrator Accounts**

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State Organization: Cabinet for Families and Children

While testing computer system vulnerability at the Cabinet for Families and Children (CFC), we found instances of lax security over administrator accounts, resulting in the potential of machines being vulnerable to intrusion. These instances vary in severity, but illustrate that CFC local area networks were vulnerable during FY 02.

We found one (1) machine in which we were able to gain “Master” access through Structured Query Language (SQL) (port 1433) using the default administrator logon. This type of access will provide an unauthorized user with complete access to the application. Further, the user would be granted local system account rights to the server on which the application resides.

The administrator account for one (1) server had not been renamed or disabled. Since the administrator cannot be locked out, if the account is not renamed, the server could be vulnerable to a potential intruder attempt to gain access by guessing the administrator password through a brute force attack.

Administrator accounts are very powerful and can allow full access to the system. Therefore, these accounts should be secured as much as possible. At a minimum, the passwords for these accounts should be changed from the system defaults. Further, some administrator accounts can be renamed to help obscure them from an unauthorized user’s view.

**Recommendation**

We recommend CFC review all machines to ensure the local administrator accounts have been changed from the default-naming conventions and require the use of a password. Further, all applications that might allow a user access to the system or to configuration settings should be reviewed to ensure that default logons are not allowed.

**Management’s Response and Corrective Action Plan**

*Port scans have been done on networks, specifically for Port 1433, to identify servers running SQL. If found open, SQL has been removed or the administrator password has been changed. We will continue to do Port scans to see that no unauthorized devices have SQL on them or that the passwords are set according to policy.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-CFC2-3: The Cabinet For Families And Children’s Password Policy Should Be Consistently Applied To All Local Area Network Servers**

State Organization: Cabinet for Families and Children

As was noted in the prior audit, password policies established on servers did not adhere to CFC password policies. During the FY 02 audit, we were able to glean account-related information from 44 servers within three (3) CFC domains. We examined the password policies on these machines to ensure that they adhered to policy statements, Governor’s Office for Technology (GOT) Password Strength Policies, and industry standards. The following table illustrates the outcome of this review.

<b>Security Measure</b>	<b>Standard</b>	<b>Number of machines not in compliance with policy (and the expiration setting on those machines)</b>	<b>Percentage of 41 machines not in compliance with policy</b>
Maximum Age	31 days – GOT	33 = None 8 = 42 Days	100%
Minimum Age	1 day – GOT	41 = None	100%
Minimum Length	5 characters – GOT	33 = 4 8 = None	100%
Lockout Threshold	5 attempts – GOT	8 = None	19.5%
Lockout Duration	“Forever” – Industry Standard is set for 71,582,788 minutes (approximately 136.2 years)	33 = 30 minutes 8 = 26 minutes	100%
Lockout Reset	1,440 minutes – Industry Standard	33 = 30 minutes 8 = 25 minutes	100%

Passwords are an important aspect of computer security. They are the front line of protection for system access. To help ensure the security of a network, it is necessary for a strong password policy to be developed and implemented on all servers within the network in a consistent manner. If servers within a network are not sufficiently secured, the network could be compromised.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-CFC2-3: The Cabinet For Families And Children’s Password Policy  
Should Be Consistently Applied To All Local Area Network Servers (Continued)**

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**Recommendation**

We recommend that CFC review all servers within its domains to ensure the password policy established complies with the specific guidelines

**Management’s Response and Corrective Action Plan**

*We have developed and adopted a password policy that is in line with the GOT recommendations. Our lockout duration standard has been changed to your recommendation of “Forever.” The lockout reset has been changed to 90 minutes. However, we feel if we go with the GOT standard of 1440 minutes for the lockout reset, this would put an undue burden on our support staff and the helpdesks.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-FAC1-4: The Finance And Administration Cabinet Should Closely Monitor The Progress Of The Disparity Study Relating To Set-Aside Laws**

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State Organization: Finance and Administration Cabinet

During our audit of the CAFR for FY 99, we reported that policies and procedures related to Small or Minority Business Set-Aside Laws were not being implemented by the Finance and Administration Cabinet (FAC), Division of Contracting and Administration. Our audit follow-up to this finding for FY 00 determined that no further action had been taken since our initial finding. In response to this FY 99 finding, FAC management responded that a Disparity Study (Study) was a necessary measure for implementing set-aside laws. FAC contracted with an outside vendor to conduct the Study. The Study was to be released February 2001 and no later than March 2001. In FY 01, during our follow-up to this finding, FAC responded that the Study had not been finalized, and it was anticipated that the Study would be completed in the near future. That was as of May 1, 2002.

Based on information obtained during FY 02 follow-up, as of November 1, 2002, the Study had yet to be completed. In addition, we have determined that FAC has paid approximately \$590,000 to the firm contracted to complete the Study over the past three (3) fiscal years.

**Recommendation**

We recommend FAC determine the reasons the Study has not been completed. We further recommend FAC either take the necessary actions recommended by the Study, if feasible, or implement procedures to comply with the Small or Minority Business Set-Aside Laws.

**Management's Response and Corrective Action Plan**

*The Finance and Administration Cabinet is in the process of providing additional data to Griffin and Strong, the consultant for the Disparity Study, for inclusion in their report. Our timeline is to provide this data to Griffin and Strong by the end of December 2002. Griffin and Strong is committed to finalizing the Disparity Study and issuing the final report by the end of January 2003. When the Disparity Study is complete the Finance and Administration Cabinet will develop an action plan to implement findings, when feasible, to comply with KRS 45A.675.*

**Auditor's Reply**

Subsequent to FAC's response to this finding, the Study was released. We will review the report and the actions taken by FAC as a result of the study in the upcoming audit.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-FAC2-5: The Finance And Administration Cabinet Should Ensure Consistent Classification And Categorization Of Investments In The Cash And Investment Note**

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State Organization: Finance and Administration Cabinet

The FAC CAFR team prepares the Cash and Investments note (Note 5). The CAFR team uses a confirmation database to compile summary sheets for each component unit of the Commonwealth. The confirmation database includes Management Administrative Reporting System (MARS) account numbers, funds, agency numbers, cash balances, cash on hand, book values for short and long term investments, and market values for short- and long-term investments. The summary sheets for each component unit provide cash and investments classifications and categorizations. In reviewing Note 5 information for each component unit, problems were noted in the classification and categorization of cash and investments. Those problems are summarized below.

**Classification**

In reviewing the summary sheets prepared by FAC, we noted some classification errors in FY 01. This year we noted the same problem. For example, although there has been significant improvement since last year, the State Investment Pool (SIP) funds were still not handled consistently between cash and investments classifications. FAC reported the SIP funds in two (2) different ways. Sometimes SIP cash and investments were reported as a total under investments. Other times, the SIP cash was reported as cash on the summary sheet, and the SIP investments were reported as a separate line item under investments. The SIP cash should be shown in the cash section of the summary sheet, and the investments should be shown in the investments section of the summary sheet.

Also, some funds were not classified as the correct type of investment. For example, commercial paper was classified as a non-negotiable certificate of deposit for the Kentucky Infrastructure Authority.

Improper classification could cause the Note 5 cash or investment balances to be overstated or understated. Although the total cash and investments reported on the Statement of Net Assets is correct, the individual cash and investment categories (current/noncurrent) would be misstated. In effect, this could mislead a user as to the liquidity and asset allocation of the Commonwealth's SIP.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-FAC2-5: The Finance And Administration Cabinet Should Ensure Consistent Classification And Categorization Of Investments In The Cash And Investment Note (Continued)**

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**Classification (Continued)**

Improper classification of cash and investment types would cause the Note 5 disclosure to not agree with the classification of cash and investments reported in the Statement of Net Assets. This could mislead a user as to the liquidity and asset allocation of the Commonwealth's cash and investment portfolio holdings.

According to the Implementation Guide for the Governmental Accounting Standards Board (GASB) 9, Footnote 5, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*,

. . . cash includes not only currency on hand, but also demand deposits with banks or financial institutions. Cash also includes deposits in other kinds of accounts or cash management pools that have the general characteristics of demand deposit accounts in that the governmental enterprise may deposit additional cash at any time and also withdraw cash at any time without prior notice or penalty. . .

In relation to this issue, question 15 of the Implementation Guide states, “. . .the equity in an internal cash management or investment pool should not be considered cash unless the funds can be withdrawn at any time without prior notice or penalty. . .”

Moreover, question 15 notes for cash flow reporting purposes, the equity in a pool that is sufficiently liquid to enable withdrawal without prior notice or penalty should be treated as cash, and otherwise the equity should be considered an investment.

Good internal controls dictate that investments be classified correctly according to type.

**Categorization**

In reviewing the summary sheets prepared by FAC, some categorization errors were noted again this year, although improvement was made over the prior year. For example, SIP cash should be listed as category 1 cash/cash equivalents. However, on the Insurance Administration's summary sheet, this amount was listed as category 3 cash. Similarly, the University of Louisville's category 3 investments were listed as category 1 investments. Both of these items were corrected prior to the release of the CAFR.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-FAC2-5: The Finance And Administration Cabinet Should Ensure Consistent Classification And Categorization Of Investments In The Cash And Investment Note (Continued)**

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**Categorization (Continued)**

Improper categorization could cause Note 5 cash and/or investments to be overstated/understated, which could mislead the user about the credit risk for a particular investment.

According to GASB 3 Implementation Guide, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*, Question 4, provides there are three (3) credit risk categories used to report cash and investments information depending on “who the securities custodian is and how the securities custodian holds the security.”

The categories required for reporting are as follows:

1. The custodian is the government’s agent and is not the counterparty or the counterparty financial institution’s trust department. The custodian holds the securities in the government’s name.
2. The custodian is the counterparty financial institution’s trust department or the counterparty’s agent and the custodian holds the securities in the government’s name.
3. The custodian is the counterparty, regardless of whether it holds the securities in government’s name.

OR The custodian is the counterparty financial institution’s trust department or the counterparty’s agent and the custodian does not hold the securities in the government’s name.

If the investment is not insured or registered or if collateral or investment is not in the possession of the government, then the investment is required to be categorized in one of the above categories.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-FAC2-5: The Finance And Administration Cabinet Should Ensure Consistent Classification And Categorization Of Investments In The Cash And Investment Note (Continued)**

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**Recommendation**

**Classification**

Although we noted significant improvement in the proper classification of SIP cash, we recommend FAC set a specific policy on the classification of SIP cash and investments and inform component units and their auditors of the policy.

**Categorization**

We recommend consistent and proper categorization of investments for each component unit for Note 5, as required by GASB 3.

**Management's Response and Corrective Action Plan**

*We agree that the Finance and Administration Cabinet should be more consistent in categorization and classification of cash and investments. We believe most problems this year occurred primarily because of the implementation of GASB 35 by the universities. The revised AFR [Annual Financial Report] forms and confirmation report should provide more uniformity and consistency in the future. Our policy is to report state investment pool cash and investments exactly as the component units report them.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-FAC3-6: The Finance And Administration Cabinet Should Develop And Consistently Apply Formal Change Management Control Procedures For The Commonwealth's Cash And Investments Statistical Analysis System Programs**

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State Organization: Finance and Administration Cabinet

As noted in the prior year's audit, the FAC, Office of Financial Management (OFM) did not develop formal program change management policies and procedures. During FY 02, the batch programs processed to generate cash and investment reports were rewritten in the Statistical Analysis System (SAS) language. These programs, implemented in May 2002, are critical to processing and reporting the Commonwealth's investments and to the Complete Asset Management, Reporting, and Accounting (CAMRA) system.

Prior to implementing the new SAS programs, OFM had designed and implemented a program change request form to reflect the necessity of modifications, description of modifications, testing of modifications, and authorization to implement modifications. However, our testing revealed seven (7) instances where modifications were made to program code without a supporting program modification request or other form of documented authorization. Further, complete formal policies and procedures for program change management were not developed.

Our examination of the program modification process also revealed several instances where acceptable business practices for system development were not employed for these SAS programs.

- Prior to the development of the SAS programs, formal program specifications were not provided to the programmer by OFM management.
- A separate library is not used for testing the SAS programs. All SAS test and production programs are housed in the same library. Further, the programmer has 'write' access to this library. The term library in this context means the same personal folder, on the same drive of one (1) server.
- The SAS program code required recurring manual modifications. These modifications caused the programmer to regularly enter accounting data directly into programs without following OFM's established program modification procedures and without supervisory review.
- The programmer has 'write' access to production data files, as well as the production programs.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-FAC3-6: The Finance And Administration Cabinet Should Develop And Consistently Apply Formal Change Management Control Procedures For The Commonwealth's Cash And Investments Statistical Analysis System Programs (Continued)**

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Without formalized controls over program modifications, management increases the risk that incorrect or unauthorized changes could be moved into the live environment and adversely affect system processing results. Failure to follow best practices when developing new programs or systems can result in inaccurate or inefficient programs, or processing that does not adequately address security concerns for program modifications.

**Recommendation**

We recommend OFM develop and implement complete formalized program change management control policies and procedures to ensure consistent procedures are followed for authorization and approval of program changes, understanding of program objectives, control and maintenance of test and production libraries, transfer of changes to production, proper segregation of duties for programmers, and supervisory responsibilities over programmer access. Further, OFM should follow best practices when developing or revamping a program or system.

**Management's Response and Corrective Action Plan**

*The Office of Financial Management has tried to incorporate the auditors input on the rewriting of our accounting software from the very beginning.*

*Formal program specifications were not given to the programmer. What was given to him was the task of replacing an existing system that had been audited by APA.*

*OFM is restructuring the read and write capabilities of all members. The programmer will not have write capabilities for production programs. Any program changes made in the future will be audited by our internal auditor to insure that only the requested and approved changes have been made.*

*Initially some manual entries were made into the program. As times goes forward automation is added to the program. At no time was the programmer able to enter data into the system without supervision and audits of output afterwards. Three staff members checked the data produced by the program. Our ultimate goal is to automate all entries.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
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**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-FAC3-6: The Finance And Administration Cabinet Should Develop And Consistently Apply Formal Change Management Control Procedures For The Commonwealth's Cash And Investments Statistical Analysis System Programs (Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

*At the recommendation of the auditors any program changes made must go through a four-stage process. Before the change is begun a supervisor must determine that a change is required. The supervisor then must check off how the programmer is going to make the change. After the change is made OFM's internal auditor audits the changes that have been made and writes a report on changes made. At this point it goes back to the supervisor for final authority to integrate the change into the production file.*

*OFM continues to strive to make the programming and maintenance of the programs correct and protected from unauthorized changes. We have already made some of the changes recommended by the APA and will shortly have all suggestions completed.*

**COMMONWEALTH OF KENTUCKY  
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**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-FAC4-7: The Office Of Financial Management Should Improve Segregation Of Duty Controls**

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State Organization: Finance and Administration Cabinet

During the cash and investments audit for FY 02, OFM did not employ proper segregation of duties between programmer, operator, and librarian functions. In May 2002, SAS programs were implemented to replace a number of EXCEL and ACCESS applications that performed accounting and reporting functions for the Commonwealth's cash and investments. The programmer employed to develop and maintain the SAS programs was provided access to production programs and data. Further, he performed several tasks deemed to be incompatible with the standard tasks of a programmer. Our review specifically noted the following:

- The program code that performs monthly processing requires the programmer to manually enter critical accounting data directly into the program. The data consists of payoff balances and adjustment amounts for each investment pool and security lending balances for the month. Available supporting documentation was not deemed sufficient to substantiate these entries. Further, the documentation did not provide evidence of supervisory review.
- The programmer manually compiles the files that are input to the program that performs month-end processing.
- For the months of May and June, the programmer manually modified daily balances for float accounts within the data file that is input to the program that performs month-end processing. The fee amounts that are calculated on these balances were not recalculated based on the modified balances. Documentation provided as support for modified balances did not document evidence of authorization or supervisory review.
- From correspondence with OFM staff, it appears the programmer had manually modified the text files for the months of May and June that are input into MARS for creation of the monthly journal voucher document.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-FAC4-7: The Office Of Financial Management Should Improve Segregation Of Duty Controls (Continued)**

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- Programs in development or testing are not controlled or segregated from the programs that are in production. Both test and production programs and data files are maintained on the programmer's personal network drive. Hence, the programmer has "write" access to the directory housing production programs and data. Further, the programmer acts as the operator for these programs. He submitted these programs for processing on a routine basis.

Employing strong segregation of duty controls decreases the opportunity for unauthorized modification to files and programs and the likelihood of losses occurring from incorrect use of data, programs, and other resources. Programmer duties should not include the input of accounting data. Program developers should be restricted from the production environment, and their activities should be conducted solely on "test" data. This will assist in ensuring an independent and objective testing environment without jeopardizing the integrity of production data. Computer operators should not have direct access to program source code. This will help ensure the computer operator does not intentionally or unintentionally introduce source code that has not been properly tested, and will lessen the opportunity of introducing malicious program code. Smaller organizations that cannot easily segregate programmer duties from development and operations should implement strict evaluation, authorization and approval procedures. Programmer activities in these circumstances should be closely monitored.

**Recommendation**

We recommend OFM take the necessary actions to discontinue the processes that allow programmer access to production programs and data. OFM should also eliminate procedures requiring the programmer to input accounting information into production programs. OFM should take the following actions to employ proper segregation of duty controls:

- Request modification to the program code that performs month-end processing to eliminate the need to manually enter accounting data. The programs should be developed to call in text or other input files generated by accounting personnel.
- Request a program be developed that will automate the compilation of daily files into the monthly text files that are input to the month-end SAS program.

**COMMONWEALTH OF KENTUCKY  
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(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-FAC4-7: The Office Of Financial Management Should Improve Segregation Of Duty Controls (Continued)**

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**Recommendation (Continued)**

- Separate the testing and production libraries and eliminate the programmer's update access to production programs and data.
- Control transfers from the testing environment to production and ensure another staff member is designated as librarian to perform this task following sufficient testing and authorized approval of the program.

Circumstances of an emergency nature requiring the programmer to have update access privileges should be documented and closely monitored at the appropriate supervisory level. For those circumstances when it is necessary to grant update access to a program or production data, a log should be created that specifically documents the individual accessing the production library by user ID (Identification), time of entry, specific programs, and data accessed and purpose. All activity should be subject to supervisory control, and system log entries should be substantiated by a formal request for the access granted.

**Management's Response and Corrective Action Plan**

*The program code was written with some flexibility to allow for unforeseen adjustments. Adjustments made using the manual process are calculated and entered by more than one person. The results are then checked by multiple individuals. The amounts entered into the month end adjustments had been calculated by the accounting staff. We do not see an issue with the programmer manually compiling files at the end of the month. We would need specifics as to what problems the auditors have and would then correct them.*

*Program development was changed in mid-July, 2002. A library was set up with access limited to an administrator who is not the programmer. Prior to mid-July programs were renamed when tested and were checked by our internal auditor. OFM has now set up a separation so the programmer is unable to access the production program.*

*All program changes are approved by his supervisor and changes audited by the Office of Financial Management's internal auditor. Only at this point in time is the new production program loaded into the library by the librarian. Programs are saved at the end of each month under a unique name for audit purposes. Automation of programs continues to be developed. All accounting data is generated by CAMRA and loaded into our SAS programs. This is an update since the end of the fiscal year.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-FAC5-8: The Finance And Administration Cabinet Should Work With American Management Systems To Strengthen Logical Security Measures Over The Management Administrative Reporting System And The Management Reporting Database**

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State Organization: Finance and Administration Cabinet

FAC did not adequately control logical security access of the Management Reporting Database (MRDB) or the Procurement Desktop (PD) and Budget Reporting and Analysis Support System (BRASS) applications.

PD is a “two-tier” security system. The initial security level is the Commonwealth’s Resource Access Control Facility (RACF). RACF determines which application systems and libraries an employee can access, and whether inquiry, alter, or update access will be allowed. Once the user accesses an application, their capabilities are controlled by the PD application. The PD application creates purchase requests; creates and issues solicitations from vendors, if necessary; awards and manages award documents, such as contracts, purchase orders, delivery orders, and master agreements; tracks the receipt of goods and services; and, creates and manages payable documents. The security features of password expiration, a lockout based on a number of unsuccessful attempts, and prevention of consecutive password usage have not been made available by the vendor American Management Systems (AMS), for this application. This application does allow for an expiration date to be entered for a PD user ID; however, this feature is not utilized for each user for it would not be feasible to have user’s IDs expire on a regular basis.

BRASS is administered through the Governor’s Office for Policy and Management and is the only component of MARS that uses a unique, three-character user ID that is separate and distinct from the RACF ID. The security features of password expiration, a lockout based on a number of unsuccessful attempts, and disallowance of consecutive password usage has not been made available by AMS for this application. After three (3) unsuccessful attempts, the application will close, but the user is not restricted from launching the application again and using the same ID with a different set of passwords.

MRDB is not an application of MARS, but a database that interacts with MARS applications to consolidate data so reports can be generated. These MARS applications include Advantage Financial, PD, and BRASS. A valid RACF ID is needed in order to access MRDB. However, a password security expiration feature has not been implemented for MRDB. The only restriction on password usage is reuse of passwords, which is not allowed.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-FAC5-8: The Finance And Administration Cabinet Should Work With American Management Systems To Strengthen Logical Security Measures Over The Management Administrative Reporting System And The Management Reporting Database (Continued)**

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To help ensure strong security over applications and the database for which data is stored, it is necessary for a strong password policy to be developed and implemented for MRDB and all applications within MARS. The likelihood of unauthorized processing, data alteration, and information leakage increases if applications and databases are not sufficiently secured. This compromises the integrity and confidentiality of the data that is processed through MARS and resides within the MRDB.

**Recommendation**

We recommend FAC work with AMS to ensure optimal security features get incorporated in new versions of PD, BRASS, and MRDB to ensure each has optimal controls established for password security, such as expiration, preferably every 30 days; restriction on consecutive usage; and, a lockout feature following, at most, three (3) unsuccessful login attempts.

**Management's Response and Corrective Action Plan**

*The planned 4.12 release of PD in October 2003 has error handling code contemplated to allow for minimum password length, forced password change, password re-use restrictions, and lockout after unsuccessful attempts. BRASS does not have these changes on a release schedule but is inquiring as to the level of effort, so they could be incorporated in future upgrades. MRDB is not a software application for which error handling must be incorporated in application code. It is no more than a set of Oracle tables representing extracts from other data sources managed through the Oracle Database Management System. While passwords are important to the MRDB, it is a "read-only" reporting system. We run Oracle routines periodically to search for weak passwords and ask users to change their passwords. We revoke user access after ample notification to change their MRDB Oracle passwords. MRDB is used for recurring reporting and to change passwords every 30 days will impose a hardship on the reporting process that doesn't meet the value test for the control. It is important to note at this juncture that BRASS, PD, and MRDB are not part of the Advantage Financial System, the Commonwealth's system of record for all financial information. The above recommendations for controls all currently exist in the Advantage Financial System.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
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**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-FAC6-9: The Finance And Administration Cabinet Should Work With The Governor's Office For Technology To Ensure The Security Log Report Is Generated, Recoverable, And Effectively Monitored**

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State Organization: Finance and Administration Cabinet

The FAC did not have controls in place that would ensure the security log report was generated, recoverable, and effective. MARS security violations are available for viewing within the security log report, FMP5G02, on-line through Document Direct or Remote Document Security (RDS). This report tracks security violations that occur in the Advantage Financial application. The most prevalent violation found within these reports is for error code \*S304 (action not authorized for agency code) and \*S302 (action not authorized). Per the Security Administrator, these error messages would be displayed for many reasons, such as:

- Entering the wrong agency code on a document;
- Failing to enter an agency code on a document; or
- Attempting to open a document/table entry for which the user does not have access.

This results in difficulty in determining whether or not the user simply made an error or was attempting to access something for which he/she did not have access. For this reason, the violation report is not reviewed on a regular basis. The report will be used for investigative purposes, if the need shall arise. For example, if an agency were to question the actions of a particular user.

Upon observation of the security log for selected run dates, we found that not all reports were available on-line through Document Direct or RDS. The security logs are missing from the end of January 2001 through the last part of August 2001. We were informed that it was likely the reports were not generated as a result of a migration being performed incorrectly. If the logs had been generated but are missing as a result of accidental or intentional destruction, the logs are not recoverable.

In addition, we found four (4) separate instances where a user had 18 security violations. There were two (2) different users associated with these violations on the same date. Though it appears that the document these users were attempting to process never made it to Advantage Financial, these instances were not brought to the Security Administrator's attention.

**COMMONWEALTH OF KENTUCKY  
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**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-FAC6-9: The Finance And Administration Cabinet Should Work With The Governor's Office For Technology To Ensure The Security Log Report Is Generated, Recoverable, And Effectively Monitored (Continued)**

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To help ensure strong security over applications, it is necessary the security log report be generated, recoverable, and effective. The likelihood of unauthorized processing and data change and information leakage increases if violations are not monitored. This compromises the integrity and confidentiality of the data processed through Advantage Financial.

**Recommendation**

We recommend FAC work with GOT to take the following steps to improve controls over the security log report:

- Implement a method of notification when the security log report is not generated.
- Implement a method of recovery in case there are missing reports as a result of accidental or intentional destruction.
- Develop filters for the security log so that it will be more useful for review and security notifications. If this cannot be done with the logging software, FAC should consider obtaining additional software to assist with the security log filtering and report development.
- Ensure the security log or resulting reports are adequately monitored and violations are investigated in a timely manner.

**Management's Response and Corrective Action Plan**

*Any job (including reports) that abends in the nightly cycle shows up on the nightly note. Any job that abends at night can be re-run in the morning and posted to RDS provided the input files are not dynamic and don't change until the next cycle. Our previous issue referenced above wasn't that the reports didn't run, they just got out of the schedule to be posted to RDS when changes were made to the RDS environment. To solve the above problem and make the reports easier to use, we propose to place steps in the report job to append the daily detail lines to FINA.AFN1.SEQ.KR5G02 data set on the mainframe. This file can be FTPed and brought into MSAccess on a periodic basis allowing full database search functionality. At the end of each year the database will be archived to CD Rom and provided to the APA.*

**COMMONWEALTH OF KENTUCKY  
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**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-FAC7-10: The Finance And Administration Cabinet Should Ensure All User Accounts On The Agency Servers Are Necessary**

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State Organization: Finance and Administration Cabinet

While performing interim vulnerability tests of FAC, we found several instances where unnecessary accounts were established on servers or for applications.

To examine the information provided by NetBIOS, we limited our review to 37 machines, including the Primary Domain Controller (PDC), Backup Domain Controllers, SQL servers, and NT servers. NetBIOS account information was received from seven (7) servers, including the PDC, within the FAC domain. We examined this information to search for disabled or unused user accounts. The PDC contained 32 disabled accounts. To determine possible unnecessary accounts, we used the criteria that the account was over the 31-day maximum password age established by FAC policy and had never logged onto the system. The PDC had 325 accounts that met this criterion. Further, while examining other FAC servers, we found the guest account on three (3) servers and two (2) user accounts on one (1) server met our criteria for potentially unnecessary accounts.

We attempted a remote logon to known applications using various combinations of default logon passwords. A review of all machines controlled by FAC revealed 85 machines with port 21 open and 67 machines with port 23 open. We were able to create a File Transfer Protocol (FTP) session through port 21 on 48 machines, or 56.5 percent, using the anonymous or guest logins. In addition, Telnet sessions could be established with no login or through the anonymous or guest default logins on 45 machines, or 67.2 percent, through port 23.

Intruders often use inactive accounts to break into a network. If a user account has not been used for a period of time, the account should be disabled until it is needed. This minimizes the possibility that an unauthorized user will use the account. An account should be deleted if it is not going to be reinstated. Further, default administrator, guest, and anonymous accounts in operating systems and applications are some of the first accounts that an intruder will attempt to use. Therefore, they should be assigned strong passwords or, if possible, renamed or removed immediately after installation.

**Recommendation**

We recommend FAC review accounts on all servers to determine which accounts had no password change within the last 31 days. These accounts should be evaluated to determine if they are still valid accounts required for a business-related purpose. If not, the accounts should be disabled or deleted as appropriate.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
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**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-FAC7-10: The Finance And Administration Cabinet Should Ensure  
All User Accounts On The Agency Servers Are Necessary (Continued)**

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**Recommendation (Continued)**

Further, FAC should ensure all machines with FTP or Telnet services running on them restrict access to default, anonymous, or guest logons.

**Management's Response and Corrective Action Plan**

- *Account Policies have been put in place, in addition to local administration account being modified every thirty days. Accounts over a certain time period are being reviewed for deletion.*
- *FTP and Telnet ports are being reviewed and discussed as part of the FINANCE Cabinet discussions with GOT and the Firewall Solution they provide as a service to the Cabinet.*
- *Internally any Services using well known Port numbers have been reviewed and services removed and/or disabled.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
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(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-FAC8-11: The Finance And Administration Cabinet Should Strengthen The Security Of Administrator Accounts**

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State Organization: Finance and Administration Cabinet

Vulnerability testing of FAC machines revealed several instances of lax security over administrator accounts, resulting in the potential of machines being vulnerable to intrusion.

We examined 37 FAC servers and found two (2) with blank local administrator account passwords. We were able to connect to and gain control of these servers. These vulnerabilities existed as of April 2002. However, these vulnerabilities were corrected by the end of the fiscal year. Also, the administrator account for seven (7) servers had not been renamed or disabled. Since the administrator cannot be locked out, if the account is not renamed, the server could be vulnerable to a potential intruder attempted to gain access by guessing the administrator password through a brute force attack.

Further, we examined all FAC controlled servers for specific applications that could be vulnerable and found four (4) machines with port 1433 open. One (1) server allowed the auditors to gain “Master” access through SQL using the default administrator logon. This type of access would provide an unauthorized user with complete access to the application. In addition, the user would be granted local system account rights to the server on which the application resides.

We found two (2) machines with port 80 open, allowing “Read/Write/All” access to remote administration of a switch through a default logon. This type of access would provide an unauthorized user rights to view and alter the switch configuration.

Administrator accounts are very powerful and can allow full access to the system. Therefore, these accounts should be scrutinized to ensure they are adequately secured. At a minimum, the passwords for these accounts should be changed from the system defaults. Further, some administrator accounts can be renamed to help obscure them from an unauthorized user’s view.

**Recommendation**

We recommend FAC review all machines to ensure the local administrator accounts have been changed from the default naming conventions and require the use of a password. Further, all applications that might allow a user access to the system or to configuration settings should be reviewed to ensure default logons are not allowed.

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**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-FAC8-11: The Finance And Administration Cabinet Should Strengthen The Security Of Administrator Accounts (Continued)**

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**Management's Response and Corrective Action Plan**

- *Local Administrator Accounts are being monitored now and will be changed on a regular basis.*
- *The SQL Server machine in question (using the default Administrator Password) was installed as a Demonstration of SQL Server. This machine has since been shut down and re-formatted.*
- *Port 80 open allowing Read/Write/All access to remote administration of a switch through a default logon has been changed.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
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**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-FAC9-12: The Finance And Administration Cabinet Should Ensure All Open Ports On Agency Machines Have A Business-Related Purpose**

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State Organization: Finance and Administration Cabinet

During the interim security vulnerability assessment testing for servers controlled by FAC, we found several FAC servers with ports open that may not have a specific business-related purpose. Due to the large number of issues, the findings are grouped below by port number and application.

We tested machines based on the potential for misuse of port access. We originally tested 37 FAC servers, then expanded testing to all FAC controlled machines to examine ports 80, 443, and 8000.

Port 7 – Echo and Port 19 - Chargen

Three (3) servers had both ports 7 and 19 open. These ports are not necessary for the function of the server and could potentially be used to perpetuate a Denial of Service (DoS) attack.

Port 70 - Gopher

Two (2) servers had port 70 open. This port supports the obsolete Gopher application, which is no longer needed. Despite some efforts to revive Gopher, virtually all Gopher servers are no longer active. Therefore, it is likely that this port is not needed for a business purpose.

Port 80 – Hypertext Transfer Protocol (HTTP)

Port 80 was open on 47 machines that would not display the website. When no default page or restricted logon is required, normally this means that no application/web service is running at the port. Additionally, configuration information for printers or print servers was provided by 49 websites. This situation allows too much access to an unauthorized or anonymous user. Finally, using one (1) vulnerability assessment tool we determined that anonymous viewing restrictions were needed for several well-known web service directories present on one (1) server. We were able to access four (4) of these directories and view the pages without restriction.

Port 443 – Hypertext Transfer Protocol over Secure Socket Layer (HTTPS)

Nine (9) servers were found with port 443 open but would not display a website. When no default page or restricted logon is required, normally this means that no application/web service is running at the port.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
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**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-FAC9-12: The Finance And Administration Cabinet Should Ensure All Open Ports On Agency Machines Have A Business-Related Purpose (Continued)**

Port 6667 – Internet Relay Chat

Five (5) servers in the FAC domain were discovered with port 6667 open. This port can be used for several serious exploitations, such as DoS attacks, Trojan horse attacks, and downloading of illegal files. This port could be useful to a hacker and should only be used for a necessary business-related application.

Port 8000 – HTTP

Twenty-six (26) servers owned by FAC were discovered that had port 8000 open. Seventeen (17) of these servers do not display the website. These do not appear to have an application/web service running on them. The remaining nine (9) servers revealed configuration information for printers/print servers. This situation allows too much access to an unauthorized user.

Other Ports

Four (4) servers had ports open that do not appear to specifically relate to known business applications. FAC should review all open ports on servers to ensure that all have a valid business-related purpose.

The existence of open ports is an invitation for intruders to enter your system. To minimize the risk of unauthorized access to a machine, only necessary, business-related ports should be open, and all applications residing at these ports should be secured to the extent possible.

**Recommendation**

We recommend FAC perform a review of all open ports on the servers discussed in this comment. If there is not a specific, business-related purpose requiring a port to be open, then that port should be closed. Further, we recommend FAC begin a periodic review of open ports on all machines owned by the agency to ensure necessity.

**Management's Response and Corrective Action Plan**

*FINANCE is currently working with GOT Firewall support personnel to configure a Firewall solution to further protect the FINANCE Cabinet Data and resources from outside attack.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
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(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-CHS1-13: The Cabinet For Health Services Should Strengthen The Security Of System Administrator Accounts**

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State Organization: Cabinet for Health Services

Vulnerability testing of Cabinet for Health Services (CHS) servers revealed several instances of lax security over system administrator accounts, resulting in the potential of servers being vulnerable to intrusion.

We examined 33 CHS servers that provided NetBIOS information and found the system administrator account for 12 servers, or 36 percent, had not been renamed or disabled. Since the administrator cannot be locked out, if the account is not renamed, the server could be vulnerable to an intruder attempting to gain system access by guessing the administrator password through a brute force attack.

Further, we examined the CHS servers for specific application vulnerabilities and found 15 machines with port 1433 open. Eight (8) servers allowed the auditors to gain “Master” access through SQL using the default administrator logon. This type of access would provide an unauthorized user with complete access to the application. In addition, the user would be granted local system account rights to the server on which the application resides. At the time of writing this comment, all but one of these servers had been changed to prohibit access to SQL through the default logon.

Administrator accounts are very powerful and can allow full access to the system. To ensure that these accounts are adequately secured, passwords should be changed from the system defaults. Further, some administrator accounts can be renamed to help obscure them from an unauthorized user’s view.

**Recommendation**

We recommend CHS review all servers to ensure the system administrator accounts have been changed from the default-naming conventions and require the use of a password. Further, all applications that might allow a user access to the system or to configuration settings should be reviewed to ensure default logons are not allowed.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
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**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-CHS1-13: The Cabinet For Health Services Should Strengthen The Security Of System Administrator Accounts (Continued)**

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**Management's Response and Corrective Action Plan**

*CHS concurs with the recommendation of the APA and implemented corrective actions, effective September 2002, requiring system administrator accounts within the CHS domain to be renamed. The Division of Technology Resources (DTR) will conduct periodic internal audits, effective January 2003, to ascertain compliance with this recommendation.*

*Effective December 2002, DTR implemented a policy requiring server administrator passwords to be complex and to establish periodic testing and updates.*

*The DTR established administrator passwords on all MSSQL [Microsoft Structured Query Language] databases in CHS in July 2002. To reinforce this security vulnerability, the DTR created, in October 2002, a Cabinet policy indicating that no software applications were to be installed on any desktop machines except by experienced and authorized information technology personnel.*

*Effective January 2003, DTR will:*

- Complete it's audit of administrator accounts and passwords.*
- Report to CHS executive staff regarding the need to educate staff on the policy in effect regarding no unauthorized installation of computer applications.*
- Include an article in the CHS Checkup newsletter to inform staff on the presence of the policy regarding installation of computer applications.*
- Increase the frequency of network audits conducted by DTR in order to validate compliance with this Cabinet policy.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
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(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-CHS2-14: The Vital Statistics Branch Should Improve Controls Over Assets And Separate Work Tasks**

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State Organization: Cabinet for Health Services

The Vital Statistics Branch issues birth, death, marriage, and divorce certificates. Fees for these certificates are received from walk-in, mail, and phone requests. Due to two (2) instances of fraud during FY 00, the APA has given closer attention to the Vital Statistics Branch. We noted the following control weaknesses:

- 1) As reported in the two (2) previous audits, deposits were left unattended for inappropriate periods of time. This process, while somewhat improved, remains inadequate.
- 2) Certificates that must be voided are not retained and all procedures for the voiding of certificates are not properly segregated among employees. Because voided certificates are not retained, it is impossible to verify that the certificates were truly voided.
- 3) The rear entrance of the office does not have a door and thus non-branch employees can access areas where cash, checks, certificates, and vouchers are located. Unrestricted access through the rear door places these items at risk.
- 4) Certificate requests constitute most of the incoming mail of the branch. Mail and cash handling procedures implemented during this audit period are not adequate because the data entry operator performs all processing involved with each order received by mail. Data entry clerks, therefore, have the opportunity to misappropriate funds or misdirect information.
- 5) Funeral homes may obtain death certificates through the use of prepaid vouchers. We previously commented that the vouchers are easily counterfeited. Attempts by CHS to rectify this issue have not been successful. Also, there is a significant lack of duty segregation regarding the receipt and issuance of prepaid vouchers. This lack of segregation of duties places the payments for vouchers at risk.
- 6) Due to a lengthy receipts reconciliation process, receipts collected on one (1) business day are not deposited until two (2) business days later. KRS 41.070 (1) requires the timely deposit of public money. Delays in processing deposits increases the risk of funds being lost or stolen and deny the Commonwealth of additional interest earnings.
- 7) Documents containing citizen credit card information are not maintained in a secure manner during the workday.
- 8) Reports are run at the end of the day detailing the activity of each clerk. An Accountant III reviews the daily reports for errors, prepares the daily reconciliation, and prepares the daily deposit. This lack of segregation of duties places these receipts in jeopardy.

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**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-CHS2-14: The Vital Statistics Branch Should Improve Controls Over Assets And Separate Work Tasks (Continued)**

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- 9) The Vital Statistics Branch collects fees for certificates from walk-in traffic at the front desk. Receipts are not usually issued for cash payments. The chance of lost or stolen cash is greater without establishing proper controls.
- 10) The safe, in which blank death certificates are maintained, is left unlocked for excessive periods of time thus creating the potential for theft.
- 11) The branch maintains a supply of signed blank checks and these checks are properly stored in a locked safe. However, there is no reconciliation process in place, which would allow the branch to determine if all checks were properly accounted for. This lack of control places these checks at risk of being used fraudulently.

**Recommendation**

We recommend the following:

- 1) The Vital Statistics Branch provide better physical security over receipts. In the event of the Accountant III's absence, the branch supervisor should prepare the deposit.
- 2) The branch should have the document custodian maintain all voided certificates. In addition, someone other than the document custodian should void the certificates prior to being logged.
- 3) Install a door at the rear entrance, and the door should lock as it is shut. Only branch personnel should have access to this area.
- 4) The branch should segregate mail processing and data entry duties. A mail clerk or processor could open mail and log the contents of the correspondence—tracking requests, methods of payment, and amounts of payment. Requests should then be forwarded to data entry clerks for processing.
- 5) The branch should assign one (1) employee to be in charge of receiving the prepaid voucher money. Another employee should issue the vouchers.
- 6) The Vital Statistics Branch should deposit all receipts no later than the next business day after receiving them.
- 7) The branch should assess whether it is necessary to keep the entire fax order for possible verification of receipt of that order. If it is determined it is necessary to keep the orders, the branch should place them in a locked file.
- 8) The end-of-the day reconciliation function should be segregated from the deposit preparation function.

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**FINDING 02-CHS2-14: The Vital Statistics Branch Should Improve Controls Over Assets And Separate Work Tasks (Continued)**

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**Recommendation (Continued)**

- 9) Vital Statistics Branch should issue pre-numbered receipts (manual or numbered cash register receipt) for all walk in cash transactions. The cash register tape and the manual cash receipts should be batched and reconciled to the cash register reconciliation sheet.
- 10) The safe should only be opened by authorized personnel and should be closed and locked when not in use.
- 11) The branch should maintain an inventory log of all signed blank checks. The inventory should be reconciled two (2) to three (3) times a week.

**Management's Response and Corrective Action Plan**

- 1) *The Vital Statistics Branch feels its policies and procedures for the physical security of receipts is adequate, this was an isolated incident. It is already procedure that when the Accountant III is not present to prepare the daily deposit it is the responsibility of the Fee Control Unit Supervisor, then the Accountant I, then a specified data entry operator. On the above day mentioned, all were absent but the data entry operator. All employees have again been counseled concerning the leaving of deposits unattended or unlocked, for any period of time.*
- 2) *We are confused by the weakness mentioned in this audit comment. The current procedure in place is that if a void is necessary, the operator responsible stamps the certificate void and enters it on a log at his or her desk. The supervisor does not void the certificate. At the end of the day the supervisor crosschecks the voids with the operator's log. This is what we interpret this audit comment is asking along with the keeping of voids. Concerning the keeping of voids - the National Association for Public Health Statistics and Information Systems (NAPHSIS) published updated (9-10-02) standards for the establishment of internal policies and procedures for the handling of security paper. These standards were set by the NAPHSIS Fraud Committee and recommend that all states that use security paper to establish written policies and procedures including these recommendations. These standards recommend against the request by auditors that voids be logged and kept. The standard (Item 7) recommends voids being logged and crosschecked by a supervisor and destroyed. This procedure is currently in place. This office is not equipped to handle Item 6 that specifies all printing*

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**FINDING 02-CHS2-14: The Vital Statistics Branch Should Improve Controls Over Assets And Separate Work Tasks (Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

*should be done in a single location although all printing is done within view of a supervisor. Effective November 2002, this office will implement the recommendations that two authorized personnel are present when the safety paper is removed from the Vault security room and also the safes housing the paper on the first floor and that the logs contain a column for witness' initials; and that a log is placed at each printer (copier) for the operators (instead of at their desks as we now do).*

- 3.) *The Finance Cabinet created a personnel access security program in the CHR Building to eliminate or minimize unauthorized entry to the building complex. As a result, only authorized personnel enter through either the front or rear door of Vital Statistics. The rope system is an added method of controlling entry to the Vitals area. Based on this initiative, reasonable risk management has been established.*

*Current procedures control receipt, storage, retrieval and processing of pilferable assets. Access is reasonably controlled. As a result, to request construction funds to add doors (especially in the current environment) where no tangible decrease in asset risk can be quantified would not be prudent. In fact, the only recently recorded problems were from a) an employee and b) from a temporary worker assigned to Vitals. Changes to policies and procedures have addressed weaknesses related to those two events.*

*In light of the above, we do not agree that a documentable weakness exists that warrants the action recommended. A funds request to build added doors would not provide a benefit that justified the expense.*

- 4) *We concurred with the audit comment on this point in last year's recommendation, and we created procedures to address the recommendation. After the formal response was presented, nothing further was heard to suggest there was an issue with the response. The Vital Statistics Branch's current procedures remain the same as what was outlined in the corrective action response last year. The Department for Public Health feels that with the implementation of the new accounting system that was referred to in several audit responses that the new system will reduce problems and alleviate risks by having online tracking of data entry. The new accounting system should be implemented prior to January 2003.*

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**FINDING 02-CHS2-14: The Vital Statistics Branch Should Improve Controls Over Assets And Separate Work Tasks (Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

- 5) *Concur. Effective October 2002, the Accountant I is responsible to receive and enter the money received from funeral homes for pre-paid vouchers into the system. The Fee Control Unit Supervisor will then prepare vouchers to be issued to the funeral homes. She will also be responsible for tracking the vouchers as they are returned to Vital Statistics. Back ups will be assigned in the case of absences.*
- 6) *The Vital Statistics Office is a customer service agency and must remain open to customers until 4:30 PM daily. The deposit is kept overnight in the office safe. The report is then reconciled the following day. With the present accounting system it is necessary to have the receipts at hand in order to reconcile the daily reports. This reconciliation can take several hours, sometimes until 2:00 or 3:00 that afternoon. The procedure of then holding the deposit until the following morning has been discussed with the Financial Management and Reporting Branch (FMRB) and Vital Statistics will begin taking the deposit up to FMRB in the afternoon of reconciliation if prior to 3:30 PM. The new accounting system should alleviate this problem.*
- 7) *We concur. Effective June 18, 2002 (day after auditors' visit), the lateral file containing faxes requesting certified copies of certificates, credit card numbers, and expiration dates has been kept locked at all times except when a Vital Chek operator has needed information from the file. The faxes are disposed of every 60 days. As of October 16, 2002 the credit card number and expiration date is being redacted the day the fax is received.*
- 8) *Concur – this item is open. We agree that there are acceptable risks when one employee performs multiple duties. It is a near impossibility to separate these duties using the present Virtual Address Extension (VAX) old accounting system and with the implementation of the new accounting program (in the new Vital Statistics Information System (VSIS)) this problem should be alleviated. A daily computerized report will be run by each data entry operator. With the edits and balances that have been built into the system, it is the goal of the system to prevent data operators from having an unbalanced daily report, therefore there would be no unbalanced reports for the Accountant III to reconcile. Of course, this will be after the operators become familiar with the system. Until that time the Accountant I*

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**FINDING 02-CHS2-14: The Vital Statistics Branch Should Improve Controls Over Assets And Separate Work Tasks (Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

*will count the daily deposit prior to the Accountant III reconciling the daily report and then again count the deposit after the Acct. III has finished the reconciliation. As mentioned previously, the new system should be implemented prior to January 2003. Point of reference – the Accountant III has a list of operator ID's that is presently needed when reconciling reports, but she does not have access to each operator's password.*

- 9) *Prior to October 7, 2002 the front desk gave a receipt to any customer who requested it. As of October 7, cash register generated receipts are handed to all walk-in front desk customers. Since August 2002 the daily cash register tapes have been batched and reconciled to each operator's cash register reconciliation sheet.*
- 10) *We agree that the safe should not be left open any longer than necessary and cannot be left unattended. This safe is in the direct view of the Section Supervisor's Office (within 10 feet), and also can be seen from two Office Supervisor's desks. All three are responsible for logging the safety paper in and out of the safe to the units. The safe was placed in this position to deter unauthorized staff from entering it. Effective October 2002 when logging security paper in and out, the supervisor who opens the safe is responsible for locking it immediately after removing or replacing security paper except in the case of a positive handoff to another supervisor.*
- 11) *We were very general with our response to the 2001 related audit comment and have been following that response but effective October 2, 2002 logs are being kept in the safe for all checks issued on the Vital Chek Company. It is the responsibility of the Administrative Section Supervisor to keep the logs. Back ups have been assigned in the event of her absence (Fee Control Unit Supervisor, Accountant III, Accountant I). One log contains the date the blank checks are received from the Vital Chek Company, the number of checks received, the tracking numbers received and the signature of the Vital Statistics receiver. The second log (operator log) contains the date the operator received the check, the tracking number, on the check, and initials. Random weekly counting of remaining checks will take place. This process will show that the Vital Statistics office is striving for reasonable*

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**FINDING 02-CHS2-14: The Vital Statistics Branch Should Improve Controls Over  
Assets And Separate Work Tasks (Continued)**

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**Management’s Response and Corrective Action Plan (Continued)**

*accountability of these checks. Since these checks already state, in red, that they are payable to “Deposit Only - Vital Records”, it would be extremely hard to modify the check and then be used for personal gain.*

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**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-CHS3-15: The Vital Statistics Branch Should Take Appropriate Steps To Reduce The Identity Theft Risks**

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State Organization: Cabinet for Health Services

The Vital Statistics Branch collects and registers data relating to Kentucky births, deaths, marriages, adoptions, and divorces. We observed the branch to follow-up on prior year audit findings.

Kentucky birth and death certificates are easy to obtain fraudulently and can be used for fraudulent purposes, such as identity theft. Identity theft could be facilitated by the ease with which vital records can be obtained.

Proper internal control dictates the Vital Statistics Branch not release:

- Data which is excluded by law and
- Data which could easily facilitate identity theft or other crimes.

Kentucky is one (1) of 13 states with “open” birth records and one (1) of 19 states with “open” death records. These open records states are far less restrictive on which records are exempted from disclosure and inspection.

KRS 61.878(1) excludes some public records from disclosure under the Open Records Law. This is specifically discussed in KRS 61.878(1)(a) and (l).

When KRS 213.011(14) and KRS 213.131(1) are read together, it is clear that vital records should not be open for inspection, except where specifically authorized. KRS 213.131(1) further states “administrative regulations adopted by the cabinet shall provide for adequate standards of security and confidentiality of vital records. . .” 901 Kentucky Administrative Regulation (KAR) Chapter 5 addresses vital statistics, but these regulations do not address adequate standards of security and confidentiality of vital records.

CHS responded to a similar comment in the prior audit and referred to OAG 81-400 and OAG 82-234 as support for the requirement that it disclose “open” birth and death records. The statutes noted above were amended several years after these Attorney General’s Opinions were issued. Identity theft did not become a serious problem until after 1996.

Proper internal control dictates that the branch not release data that is excluded by law, or data which might be likely to facilitate identity theft or other crimes.

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**FINDING 02-CHS3-15: The Vital Statistics Branch Should Take Appropriate Steps  
To Reduce The Identity Theft Risks (Continued)**

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**Recommendation**

We recommend:

- The branch promulgate administrative regulations as required by KRS 213.131(1) to provide adequate standards of security and confidentiality of vital records.
- The branch take appropriate steps, including requesting legislation to exclude this data from potential misuse by persons seeking to commit identity theft or other unlawful acts. The end result should exclude any data that has the potential to be misused by persons seeking to commit identity theft or other unlawful acts.
- The branch should exclude social security numbers from death certificates subject to inspection under the Open Records law. The social security number on a death certificate released to the public should be excluded until such time as identity theft no longer appears to be a substantial risk.

**Management's Response and Corrective Action Plan**

*This audit issue is a Commonwealth policy issue under discussion in Legislative committees. The Cabinet for Health Services, the Transportation Cabinet, the Attorney General's Office and the Office for Security Coordination are working together to create appropriate legislation that will tighten security and the open access of records, aid in the prevention of identity theft, and also make penalties stronger. This item should be closed.*

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**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-PERS1-16: The Personnel Cabinet Should Provide Adequate Logical Security Controls For Access To The Uniform Payroll And Personnel System**

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State Organization: Personnel Cabinet

As noted in previous audits, the Personnel Cabinet (Personnel) has not provided adequate logical security controls for access to the Uniform Payroll and Personnel System (UPPS). Personnel has made numerous initiations as a follow-up to our prior recommendations; however, shortcomings still exist. The proposed draft of the updated computer security manual does not address network intrusion issues, and the draft has not been finalized. Additionally, we noted that control and update access of non-Personnel employees, including the GOT programmers, to UPPS Production load libraries, data files, and job control language (JCL) still exists. Specifically, we noted the following:

- One (1) GOT programmer had control access to UPPS production JCL.
- One (1) non-Personnel individual had update access to UPPS production load and UPPS global type.
- Formal procedures for monitoring GOT programmer access to identify activity had not been developed or implemented.

Update access to the Personnel load libraries, production data, and security files should be restricted to Personnel staff only. Failure to maintain proper segregation of duties for programmers and other employees increases the likelihood that an unauthorized change is possible to programs, JCL, or data. A strong control environment would not allow programmers access without adequate authorization and oversight. Circumstances of an emergency nature requiring update access privileges should be documented and closely monitored at the appropriate supervisory level. For those circumstances when it is necessary to grant update access to an application program, JCL, and/or dataset, a log should be created that specifically identifies the individual accessing the system by user ID, time of entry into the system, specific programs and data accessed, and purpose. All activity should be subject to supervisory control, and system log entries should be substantiated by a formal request to make system changes or modify system access privileges.

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**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-PERS1-16: The Personnel Cabinet Should Provide Adequate Logical Security Controls For Access To The Uniform Payroll And Personnel System (Continued)**

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Finally, formal security policies and procedures provide continuity for policy implementation, as well as set the tone of management concern for a strong system to secure assets and resources. These policies and procedures should be kept current and complete, as they provide a security framework to educate management and users of their responsibilities.

**Recommendation**

We recommend Personnel take the following steps to improve logical security of UPPS:

- Eliminate all update and control accesses for GOT programmers and non-Personnel employees. These employees should not have access to production data and/or JCL, except in specific cases. Any update or control access granted to programmers should be documented and monitored closely by Personnel management. In addition, update access should be restricted to the level required to perform the assignment for a set time period and then rescinded. We recommend someone other than a GOT programmer be chosen as a backup security administrator.
- Update accordingly, and review periodically, the Personnel Cabinet Security Policy/Procedure Manual. The manual should include some general procedures addressing unauthorized network intrusions and event handling. These general procedures would include the monitoring, detection, identification, and response to the intrusion.

**Management's Response and Corrective Action Plan**

**Personnel Cabinet Logical Security Procedures:**

*All access above READ to files and libraries by GOT programmers has already been either eliminated or reduced to READ. Personnel management has put in place a process whereby the security officer grants and rescinds access to GOT programmers on an as needed basis. Access requests to production JCL and/or data files are sent by the GOT contact to the Personnel Cabinet security officer.*

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**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-PERS1-16: The Personnel Cabinet Should Provide Adequate Logical Security Controls For Access To The Uniform Payroll And Personnel System (Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

*The process to gain a higher level of access will remain as is currently in force; i.e. a form will be submitted to the Personnel Cabinet Security Officer that has the following information:*

- 1. File to be accessed and the reason access is required.*
- 2. ID that will access the file.*
- 3. Level of access required.*
- 4. Duration of the access.*
- 5. Authorized requestor.*
- 6. Justification for the requested access*

*The Director of Employee Records Division will advise the Security Officer in GOT that is authorized to make the access change requested.*

*The Personnel Cabinet Security Officer will:*

- 1. Make the requested changes*
- 2. Notify GOT that the changes are completed*
- 3. Maintain the forms and on the date specified remove the access*

*The Personnel Cabinet Security Officer's backup is a Personnel Cabinet employee.*

*The form is then filed by "Delete Access Date " sequence. Each Monday the forms are reviewed to see if any access is to be terminated that week. When access is terminated the "Delete Access Date" is circled and the form is retained.*

*The Personnel Cabinet regards security as an on-going business concern and continues to review our logging processes and reports to assess how they meet our needs and can be improved.*

**Personnel Cabinet Security Procedures Manual:**

*The manual reviewed by the Audit Team was a **draft** copy and was not considered complete. We have identified two major changes that need to be made since*

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**FINDING 02-PERS1-16: The Personnel Cabinet Should Provide Adequate Logical Security Controls For Access To The Uniform Payroll And Personnel System (Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

*providing you with the copy as part of the audit process. The point is well taken that the manual should be reviewed and updated periodically as is our intention.*

*The first change we will make is that the section on network security will be removed and will become a separate manual. The second change is that the process for gaining access to CICS [Customer Information Control System] and Document Direct will also become a separate manual that will be given to each agency security officer, as well as being a section in the Procedures Manual.*

*This document will detail the process of requesting access to the CICS applications and Document Direct. As well as requesting access, it is equally important that agencies inform the Personnel Cabinet when an employee has changed agencies, or has left State Government so that the appropriate change or deletion can be made to their access. The agencies also need to take responsibility for their employees' access.*

*The complete "in-house" procedures manual will not be distributed beyond the appropriate Personnel Cabinet Managers or Supervisors.*

**Auditor's Reply**

The Personnel management response provided above appears to be an effective method to address the control weakness cited; however, the process described in the agency response was not implemented until after the period under audit. Therefore, during the audit period, programmers were able to update and/or change data without being properly monitored.

Our primary concern is that access by GOT programmers to Personnel production programs, JCL, and data has been cited repeatedly for many years. The explanation provided by the agency for this continued control breach is that the UPPS system is dated and requires ongoing corrections that necessitate emergency access by GOT programmers. Programmer access to production programs and data is a serious control issue that must be addressed, especially in systems affecting payments and employee time accruals.

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**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-REV1-17: The Kentucky Revenue Cabinet Should Ensure Confidential Taxpayer Information Is Protected And Preserved As Required By Statute**

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State Organization: Kentucky Revenue Cabinet

The Kentucky Revenue Cabinet (Revenue) collected 95% of the Commonwealth's total General Fund revenues, or \$6,847,097,725 in tax receipts, and refunded \$546,462,753 in overpayments to Kentucky taxpayers during the FY 02 audit period. We tested controls over Revenue's receipts, refunds, and accounts receivables and noted weaknesses at the central files repository that compromise Revenue's ability to comply with confidentiality and record retention laws.

We selected and tested samples of 58 corporate refunds, 42 corporate refund offsets, 42 individual income tax refunds, 42 receipts, and 72 receivables and noted the following problems during testing:

- Revenue failed to provide tax returns totaling \$6,604,779 in refunds to 18 corporate taxpayers; \$6,516 in refunds to two (2) individual taxpayers; and, \$722,551 in receipts and receivables from 13 Kentucky taxpayers. When tax returns are missing, we cannot determine if the returns were lost, stolen, destroyed, or ever received; thus, missing documentation causes us to question the legitimacy of a transaction, particularly when a refund is issued. Tax returns are the most persuasive evidence that is available to support that receipts and refunds are legitimate and properly recorded and classified within the financial statements. Since the primary objective of a financial audit is to obtain sufficient, competent, evidential matter to express an opinion over the financial statements, without original tax returns, we cannot verify the propriety of taxpayer receipts and refunds or provide reasonable assurance that financial statements are free of material misstatement.
- Revenue does not have the manpower and space required for maintaining five (5) years of tax returns for all Kentucky taxpayers, as required by KRS 131.185. Kentucky taxpayers filed 1,743,866 individual income tax returns for tax year 2000 alone, excluding tax returns filed by corporations and businesses. There are only 18 Revenue file room employees who are charged with the monumental task of maintaining order and ensuring accountability; thus, maintaining five (5) years of tax returns for every taxpayer in the Commonwealth is a tall order that has resulted in huge storage problems and backlogs in filing.

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**FINDING 02-REV1-17: The Kentucky Revenue Cabinet Should Ensure Confidential Taxpayer Information Is Protected And Preserved As Required By Statute (Continued)**

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- Revenue does not enforce security procedures at the central files repository. We noted the file room doors were often left open and the entrance unattended. While security cameras are in place, they are not a substitute for keeping the doors closed, nor would they prevent someone from gaining unlawful access to confidential taxpayer information. Furthermore, Revenue breaches its own file room security policies by leaving the doors open and puts taxpayers at an unnecessary risk.
- Revenue does not effectively track requisitioned files. Tax returns that were requested for FY 98 audit testing were not returned to the central files repository to be refiled until the end of the FY 02 audit; four (4) years is an excessive amount of time for files to remain outstanding.
- Revenue's FILENET system is not reliable. During FY 01, Revenue began scanning and imaging tax returns for access through FILENET, which was supposed to improve accessibility; however, according to various Revenue employees, FILENET is slow and inefficient. While FILENET has improved accessibility, it has not resolved the backlog at central files.

The backlog at central files is an ongoing problem that has been noted in prior year audits. Revenue has agreed with our recommendations, but the proposed solution of scanning and imaging through FILENET has not mitigated the problem.

A disorganized filing system compromises Revenue's ability to properly safeguard taxpayer information, as required by KRS 131.081 and 131.185. The benefits of retaining tax records are lost if the documentation cannot be easily located and retrieved at the central filing repository.

The APA annually audits the accounts of Revenue and the financial statements of the Commonwealth. Revenue is aware of the annual audit requirement and should also be aware of the necessity for maintaining tax documents in a manner that not only ensures compliance with confidentiality and record retention laws, but also ensures accountability to Kentucky taxpayers.

KRS 131.081 (15) states, "Taxpayers shall have the right to privacy with regard to the information provided on their Kentucky tax returns and reports, including any attached information or documents . . . no information pertaining to the returns, reports, or the affairs of a person's business shall be divulged by the cabinet to any person . . ."

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**FINDING 02-REV1-17: The Kentucky Revenue Cabinet Should Ensure Confidential Taxpayer Information Is Protected And Preserved As Required By Statute (Continued)**

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KRS 131.185 states, “Income tax returns shall be kept for five (5) years; primary accounting records of tax payments, seven (7) years; and records containing all data of motor vehicle registration, three (3) years . . .”

AU Section 801.05 states, “Management is responsible for ensuring that the entity complies with the laws and regulations applicable to its activities. That responsibility encompasses the identification of applicable laws and regulations and the establishment of controls designed to provide reasonable assurance that the entity complies with those laws and regulations. . .”

Revenue has a responsibility to uphold high standards of accountability.

**Recommendation**

Revenue should exhaust all resources to ensure that confidential taxpayer information is protected and preserved as required by statute and to ensure accountability to Kentucky taxpayers. Revenue should consider the following:

- Upgrading and expanding the use of the FILENET system or exploring the possibility of purchasing a more efficient system;
- Hiring temporary staff; or, if hiring additional staff is not possible,
- Enlisting the help of other Revenue employees to reduce the backlog at central files to ensure that taxpayer data is available and accessible.

**Management’s Response and Corrective Action Plan**

*Bullet Point 1: KRC has located all but four (4) of the documents originally requested.*

*Bullet Point 2: KRC does have the space required for maintaining all returns as required by the Records Retention Schedule. KRC does acknowledge the statement that additional manpower is needed at Central Files and will attempt to remedy this when budget constraints permit.*

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**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-REV1-17: The Kentucky Revenue Cabinet Should Ensure Confidential Taxpayer Information Is Protected And Preserved As Required By Statute (Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

*Bullet Point 3: KRC acknowledges the auditor's comments related to doors being left open at Central Files. The policy of maintaining security at Central files has been re-enforced with Revenue Operations Management and Central Files staff.*

*Bullet Point 4: KRC's File Requisition and Control (FRC) system does have effective and efficient methods of tracking files. The files in question were requested by the Auditor of Public Accounts' office and never entered into the FRC system. The policy of having all requisitioned files entered into the FRC system has been re-enforced with Revenue Operations Management and Central Files staff.*

*Bullet Point 5: Performance failures in the FILENET system were primarily related to the failure of the mechanical jukebox used to store and retrieve the discs on which the images were stored. KRC has migrated to magnetic cache for storage purposes, thus eliminating the need for these juke boxes.*

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**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-REV2-18: The Kentucky Revenue Cabinet Should Update The Sales Tax Database And Automate Processing Of Accelerated Tax Returns**

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State Organization: Kentucky Revenue Cabinet

We identified and tested 11 accelerated sales tax returns totaling \$156,279,105. We noted the Revenue sales tax database does not process payments that equal or exceed \$1,000,000; thus, a single transaction exceeding \$1,000,000 will show up on the Revenue mainframe report as 999,999 in a succession of lines, with the bottom line total as the balancing amount. While this is a system limitation, data that is processed in this manner is difficult for end users to understand.

During FY 01, Revenue automated the processing of its high volume sales and use and withholding tax returns through the Modernized Front End (MFE) system. The MFE is used for scanning tax returns for posting to the Revenue mainframe, depositing receipts, and imaging returns for archiving purposes. Users across Revenue with access to the FileNet System are able to view images of all items in a transaction that are scanned into the MFE. Revenue is currently in the process of upgrading the MFE system to process accelerated tax returns; the changes should be implemented by July 2003.

While FY 01 financial statement information was not affected as a result of these weaknesses, the system limitations could affect the accuracy and reliability of the Revenue reporting system. Tax information that is not captured exactly as it is reported on the tax return makes it difficult to determine that receipts were recorded at the proper amounts and increases the likelihood that errors would go undetected by Revenue.

The system weaknesses, noted herein, represent deficiencies in the design of internal controls that could result in violations of laws and regulations that could materially affect Revenue's financial reporting. Good internal controls dictate that receipts should be properly posted to computer records from supporting documentation and all data processed by significant systems should be reviewed to determine accuracy and completeness.

**Recommendation**

We recommend Revenue take the following actions to correct these weaknesses:

- Update Revenue's mainframe system to process tax payments that equal or exceed \$1,000,000; and,

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**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-REV2-18: The Kentucky Revenue Cabinet Should Update The Sales Tax Database And Automate Processing Of Accelerated Tax Returns (Continued)**

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**Recommendation (Continued)**

- Complete the update of MFE to process all accelerated sales tax returns; this would reduce manual processing and should increase mathematical accuracy, which would increase the reliability of the mainframe data. If this is not feasible, due to the magnitude of the tax payments involved, all accelerated sales tax returns should have a secondary level of review that includes verifying, editing and approving all adjustments.

**Management's Response and Corrective Action Plan**

*KRC agrees that putting accelerated sales tax returns on the MFE will provide a more effective processing tool than the current environment. This recommendation is currently in process, but it will likely not occur until FY 04.*

*However, due to the current and projected budget deficit, it will be necessary for KRC to determine whether the cost of changing the sales and use tax mainframe system for this issue is a priority. While the data may be difficult for some users to understand, the total payment is represented in its entirety on the system. This change may be more easily achieved in the event the KRC builds a new sales and use tax system.*

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**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-REV4-19: The Kentucky Revenue Cabinet Should Strengthen The Security Surrounding Administrator Accounts**

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State Organization: Kentucky Revenue Cabinet

During the vulnerability testing of Revenue machines, we found several instances of lax security over administrator accounts, resulting in the potential of machines being vulnerable to intrusion.

We examined 62 Revenue servers and found three (3) servers where the administrator account had not been renamed or disabled. Since these accounts cannot be locked out if the account is not renamed, these servers could be vulnerable to a brute force attack. Further, one (1) domain had 25 servers with administrator level accounts where passwords had not been changed from 131 to 841 days. These vulnerabilities existed as of June 30, 2002.

Further, we examined all Revenue controlled servers for specific applications running on port 1433 and found seven (7) that could be vulnerable. These seven (7) servers allowed the auditors to gain “Master” access through SQL using the default administrator logon. This type of access would provide an unauthorized user with complete access to the application. Further, the user would be granted local system account rights to the server on which the application resides.

Access to administrator accounts could provide unnecessary system privileges and can allow full access to the system. Therefore, these accounts should be secured as much as possible. At a minimum, the passwords for these accounts should be changed from the system defaults. Further, some administrator accounts could be renamed to help obscure them from an unauthorized user’s view.

**Recommendation**

We recommend Revenue review all machines to ensure that the local administrator accounts have been changed from the default-naming conventions and have a password established. Further, all applications that might allow a user access to the system or to configuration settings should be reviewed to ensure that default logons are not allowed. Finally, Revenue should ensure all administrator accounts adhere to password policies by ensuring all passwords are changed at the established expiration interval.

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**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-REV4-19: The Kentucky Revenue Cabinet Should Strengthen The Security Surrounding Administrator Accounts (Continued)**

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**Management's Response and Corrective Action Plan**

*KRC has reviewed all administrator accounts on all servers and have renamed the default administrator accounts. Using User Manager Pro software, we changed administrator account passwords on all servers and workstations in both the KRC and KRC\_MFE domains. Strong passwords will be used on all administrator accounts. Procedures have been put in place for the KRC security staff to do this on a monthly schedule.*

*Seven (7) systems allowed the auditor to gain access to MSDE [Microsoft Data Engine] databases through using the default administrator logon of SA and a blank password. KRC previously checked and made sure that default administrator passwords on all our SQL servers had been changed. However, these systems all contained MSDE, which is like a run-time version of SQL, used for development and some applications. KRC has determined which applications require the administrator logon and have changed the account name and password. Most did not require the default logon account and it has been deleted.*

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**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-REV5-20: The Kentucky Revenue Cabinet Should Ensure All Open Ports On Agency Machines Have A Business-Related Purpose**

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State Organization: Kentucky Revenue Cabinet

During the interim security vulnerability assessments for servers controlled by Revenue, we determined that there were several servers with ports open that may not have a specific business-related purpose. Additionally, we noted several web service vulnerabilities that indicate updated patches are needed. Due to the large number of issues, we have grouped the findings below by port number and application.

**Port 7 – Echo and Port 19 - Chargen**

We found two (2) servers that had both ports 7 and 19 open. These ports are not necessary for the function of the server, and could potentially be used to perpetuate a DoS attack.

**Port 80 – HTTP**

First, there were 11 machines with port 80 open that would not display the website. When no default page or restricted logon is required, normally this shows that there is no application/web service running at the port. Second, three (3) websites provided configuration information of printers or print servers. This situation allows too much access to an unauthorized or anonymous user. Third, one (1) website was the default page for Microsoft Windows NT 4.0 Option Pack. Revenue should review the necessity of this port. Finally, using one (1) assessment tool, we were able to determine that there may be several well-known web service directories present on two (2) servers that should be restricted from anonymous viewing. We were able to pull up several of these directories and see the pages without restriction.

**Port 443 – HTTPS**

Ten (10) servers were found with port 443 open but would not display a website. None of the ports appear to have an application/web service running on them.

**Port 8000 – HTTP**

One (1) server owned by Revenue was discovered that had port 8000 open. This website provided configuration information of a printer or print server. Once again, this situation allows too much access to an unauthorized or anonymous user.

**Port 8080 – World Wide Web – Proxy**

Two (2) machines were found with port 8080 open, which allowed access to the Oracle Servlet Engine web page. We were able to view the Error, Event, and HTTP logs for these servers. These pages should be restricted from anonymous viewing.

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**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-REV5-20: The Kentucky Revenue Cabinet Should Ensure All Open Ports On Agency Machines Have A Business-Related Purpose (Continued)**

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Other Ports

We discovered one (1) machine with Microsoft Personal Web Server 4.0 on it. An exploit of Internet Information Server (IIS) was used that allows access to the Disk Operating System (DOS) command line on the machine. We were able to search through folders on the C:\ and D:\ drives of the machine and found several interesting subfolders/files. Directory listings were allowed of the /cgi-bin/, /scripts/, and /\_vti\_bin/ folders. This permits an attacker to browse through scripts and executables within these directories, allowing them to target and exploit potential weaknesses.

There were three (3) machines in which the web service on Microsoft's IIS 4.0 has a buffer overrun vulnerability when a 3000+ character long request is made for an .htr file. This vulnerability could allow a remote attacker to execute arbitrary code and gain control of the computer.

We found the aexp2.htr on one (1) machine. From here, an attacker can launch password attacks against the local machine or proxy attacks against other machines on the network.

Two (2) servers had ports open that we were unable to specifically relate to known applications.

The existence of open ports is an invitation for intruders to enter the system. To minimize the risk of unauthorized access to a machine, only necessary, business-related ports should be open. Further, the application residing at these ports should be secured to the extent possible. Finally, proper maintenance requires that software patches be installed promptly on all servers to strengthen security.

**Recommendation**

We recommend Revenue perform a review of all open ports on the servers discussed in this finding. If there is not a specific, business-related purpose requiring a port to be open, then that port should be closed. Further, we recommend Revenue begin a periodic review of open ports on all machines owned by the agency to ensure necessity. Revenue should also ensure updated patches are installed on all servers under their control.

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**FINDING 02-REV5-20: The Kentucky Revenue Cabinet Should Ensure All Open Ports On Agency Machines Have A Business-Related Purpose (Continued)**

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**Management's Response and Corrective Action Plan**

*KRC reviewed all comments concerning questionable open ports found by the auditors office and have taken action to remove Web Services when not required. Also, KRC has applied all of the latest security patches from Microsoft and will, after evaluation, continue to apply patches as they become available. The review of open ports identified by the auditor's report prompted KRC to disable FTP and Web services on all servers unless it is absolutely necessary. KRC is developing a schedule of scanning all network servers for open ports and reviewing for any potential vulnerability.*

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**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-REV6-21: The Kentucky Revenue Cabinet Should Ensure All User Accounts On The Agency Servers Are Necessary**

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State Organization: Kentucky Revenue Cabinet

During the interim vulnerability reviews of Revenue, we discovered several instances where accounts were established either on servers or for applications, but did not appear to be necessary.

First, we reviewed NetBIOS account information on 35 servers within three (3) of the Revenue domains, one (1) of which was the PDC for unused or disabled accounts. On the PDC within the KRC\_MFE domain, there were 45 accounts that had not changed their password in more than 30 days, with 35 of them having never logged onto the system. There were also eight (8) accounts listed as disabled.

Second, we used three (3) different tools and attempted remote logon to known applications with default logon combinations. We were able to create a FTP session through port 21 on 12 machines with the anonymous or guest logins. Some of these servers allowed connection without having to provide any type of user ID or password.

Intruders often use inactive accounts to break into a network. If a user account has not been utilized for some time, the account should be disabled until it is needed. This minimizes the possibility that an unauthorized user will utilize the account. If an account is not going to be reinstated, then it should be deleted. Further, default administrator, guest, and anonymous accounts in operating systems and applications are some of the first accounts that an intruder will attempt to use. They should be assigned strong passwords or, where possible, renamed or removed immediately after installation.

**Recommendation**

We recommend that Revenue review accounts on all servers to determine which accounts have not changed their password within the last 31 days. These accounts should be evaluated to conclude if they are still valid accounts that are required for a business-related purpose. If not, the accounts should be disabled or deleted, depending on the necessity of reinstatement of the account. Further, Revenue should ensure that all machines with FTP services running on them restrict access to default, anonymous, or guest logons.

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**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-REV6-21: The Kentucky Revenue Cabinet Should Ensure All User Accounts On The Agency Servers Are Necessary (Continued)**

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**Management's Response and Corrective Action Plan**

*Revenue has reviewed accounts on all servers and removed or renamed all default administrator accounts and guest login accounts. Using User Manager Pro software, we changed administrator account passwords on all servers and workstations in both the KRC and KRC\_MFE domains. Strong passwords will be used on all administrator accounts. Procedures have been put in place for the KRC security staff to do this on a monthly schedule. The eight inactive accounts that were identified by the Auditors were reviewed and it was determined that they could be deleted. KRC reviewed the forty-five accounts on the KRC\_MFE domain and have reduced the number to twenty-seven accounts. There are twelve more accounts that may be potentially be deleted within the next month. Only those accounts that are necessary as system accounts and to run services will be retained.*

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**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-KST1-22: The Office Of The Kentucky State Treasurer Should Ensure Significant Accounting Functions Are Adequately Separated To Reduce The Risk Of Errors**

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State Agency: Office of the Kentucky State Treasurer

The Office of the Kentucky State Treasurer prepares all cash/check deposits for the Commonwealth on a daily basis. The cash/checks received from the agency are accompanied by a cash receipt (CR) document. The CR document is then approved in the accounting system after Treasury verifies the amount of the CR document to the actual cash/checks received and the online accounting system. A bank courier picks up the deposits several times throughout the day. All cash/checks not processed for the business day are stored in a safe and are processed on the next business day.

During our review of the receipt deposit function we noticed several control weaknesses by staff within the deposit room:

- All staff may initially enter the cash/checks received from the agency into the control log; however, there is no record in the log of the amount of each deposit received;
- All staff have access to the deposit room safe;
- All staff have the ability to create a deposit without any separation of duties between logging in deposits and creating a deposit;
- All staff have the approvals necessary to create, change, and/or remove the accompanying CR online documentation provided by the agencies;
- The amount of the deposits, both cash/checks, stored overnight in the safe, is not documented before being placed into the safe.

Failure to perform and/or adequately separate receipt and deposit duties significantly impairs the internal control structure and increases the risk of misappropriation of assets and material misstatements to the financial statements.

An internal control structure should provide controls to ensure compliance with laws and regulations, safeguard assets, check the accuracy and reliability of accounting data, and promote operational efficiency. A good internal control structure is essential for the achievement of full accountability. Given the current staffing situations throughout state government, it is imperative to ensure that significant accounting functions be adequately separated to reduce the risk of errors.

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**FINDING 02-KST1-22: The Office Of The Kentucky State Treasurer Should Ensure Significant Accounting Functions Are Adequately Separated To Reduce The Risk Of Errors (Continued)**

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**Recommendation**

We recommend the following be considered:

- When cash/checks are initially received from the agency, an employee who is not part of the deposit room staff should handle the log-in procedure.
- Access to the safe should require at least two (2) employees, who should be required to log-in and log-out during entry and exit to the safe.
- Access to the safe should be limited to a minimum number of employees and should, at a minimum, include the branch manager.
- Only the 4<sup>th</sup> level of approval should be given to those employees who handle and process the cash to be deposited.
- Storing deposits in locked safe deposit bags and custody of key-locked bags should remain with the director and branch manager.
- For procedures discussed here not currently documented in a procedures manual, update the manual to include any newly created procedures.

**Management's Response and Corrective Action Plan**

*The Treasury Department does understand and appreciate the concerns raised by the State Auditor, and we agree that the recommendations could improve to some degree the controls and the security in our office. However, we are torn between what would be desirable in an ideal world of unlimited budgets and abundant staffing, and what is possible in the real world in which we have to operate. The auditor himself alludes to our predicament when he refers to "the current staffing situations throughout state government." No matter how desirable the procedures may be, the Treasury Department cannot add additional time-consuming procedures in its deposit function and continue to make its deposits in a timely manner to maximize investment earnings for the Commonwealth.*

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**FINDING 02-KST1-22: The Office Of The Kentucky State Treasurer Should Ensure Significant Accounting Functions Are Adequately Separated To Reduce The Risk Of Errors (Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

*We certainly would agree that separation of duties is highly desirable, particularly when one is dealing with money. However, the reality of the situation is that there are only three people that work in the Treasury Department's Deposit Room. These three people are charged with the responsibility of receiving, processing, and depositing all of the state monies which enter through the Treasury Department.*

*There are no other employees available to assist on a regular basis with this responsibility. There is not "an employee that is not part of the deposit room staff" available to handle the receipt procedure for deposits. We wish there were but there is not, and we see no possibility in the immediate future of having such a person.*

*The entire Deposit Room staff does have access to the Deposit Room safe. They do not have the combination (only the Supervisor, a Branch Manager, and the Division Director do), but once the safe is open they do have access to their work which is contained in that safe. We do not consider this a weakness in any way. To the contrary, we consider it a point of strength. The Deposit Room employees share their responsibilities equally. If one is absent, the others must be fully empowered and prepared to continue the work of the Deposit Room. This includes accessing their own work without having to have it parceled out to them by a supervisor who may be otherwise occupied. The Deposit Room employees are tenured, trusted, and responsible employees of the Treasurer's Office who are carefully selected for their jobs. They have a great deal of responsibility, and they work under a high level of expectation that they will get the job of depositing the state's monies done each day. It would be very counterproductive to create a system under which the Deposit Room employees could not access their own work unless it was given to them by a supervisor who may not be available. We are, after all, talking about **three** people who work closely together as a team. Those team members need to be empowered to do their jobs. The job descriptions of each staff member of the Treasury Deposit Room encompass a wide variety of duties, all of which entail the assignment and the acceptance of a high level of responsibility.*

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**FINDING 02-KST1-22: The Office Of The Kentucky State Treasurer Should Ensure Significant Accounting Functions Are Adequately Separated To Reduce The Risk Of Errors (Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

*In the same vein, we also fail to see any great benefit to be derived from a policy of requiring two people to enter the Deposit Room safe, and having them sign in and out with each entry. This would just seem to add an unnecessary inconvenience that would further slow the activities of the Deposit Room. First of all, the safe is entered multiple times during the day for various reasons. To require two people to stop their work and walk over to sign in would seem to be an unnecessary distraction. In the closed and close environment of the Deposit Room, any activity such as opening the safe is done in full view of the other employees. A log-in and log-out procedure requiring two employees would not add any appreciable level of security.*

*Secondly, the benefit to be derived from a log-in, log-out procedure would be largely contingent upon knowing precisely what was being put in and taken out. This will not always be possible with the CR documents containing checks and currency. Although the goal of the Deposit Room is always to get all deposits to the bank the day that they are received, this does not always happen. During the busiest times, especially when the Revenue Cabinet deposits are heavy, there can be a large volume of agency Cash Receipt documents and deposits which are held over for processing the next day. Because of the volume and the time involved, it is not feasible to record manually each document and amount at the end of the day, and recheck those at the beginning of the next day. The Deposit Room staff's time is much better spent processing the deposits than meticulously recording the work that remains to be done. With such a limited staff we have to establish priorities, and the number one priority is getting the money to the bank in a timely manner. Extraneous activities which will slow this process need to be evaluated for their overall importance and, whenever possible, be kept to a minimum.*

*Storing deposits in locked safety deposit bags in the Deposit Room safe would seem to have very little benefit as well, for many of the same reasons cited above. We fail to see how this would add any significant level of security, since the people having the keys to the bags would presumably be the same people having the combination to the safe. As soon as the safe would be opened in the morning, the pending deposits would be removed from the bags. We do not see how this would be any safer than merely having the deposits in a locked steel safe in a locked Deposit Room in a locked office. At a time of high volume, when there*

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**FINDING 02-KST1-22: The Office Of The Kentucky State Treasurer Should Ensure Significant Accounting Functions Are Adequately Separated To Reduce The Risk Of Errors (Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

*may be several boxes of holdover deposits (some already prepared for transmittal to the bank), it would be difficult to even fit those boxes into bulky canvas bags for overnight storage.*

*Another area of concern raised is the fact that each Deposit Room staff member has the authority to affix or remove all levels of approval on CR documents. While we understand the Auditor's concern, we must strongly insist that this is a level of authority which is **absolutely essential** for the efficient operation of the Deposit Room. We must not lose sight of the fact that this is deposit authority, not expenditure authority. This authority is used in the correction of errors on CR documents, particular when CR documents cross over months during their processing. There are generally two scenarios in the error correction process.*

*The first occurs when the total of checks and cash run by the Treasury Department does not agree with the amount shown on the CR document. In some cases the Treasury employees can locate the error. In others, they have to have the assistance of the agency employees. In every case, however, the Deposit Room staff members contact the agency submitting the deposit to tell them of the error and ask that they make the necessary corrections in the deposit document. In some instances the agency employee that prepared the document knows what correction needs to be made, but cannot line up all of the agency personnel necessary to unapproved and re-approve the document so that he or she can make the correction. In such cases the Treasury Deposit Room employee can unapproved the document, allow the correction to be made at the agency level or make the correction in consultation with the agency representative, and then re-approve the corrected document so that the checks can be sent to the bank and the document can post in MARS. It is very important that this be done in a timely manner. In most cases when an error is discovered, the checks have already been encoded and endorsed with the current date. If the checks are not sent to the bank at that time, the audit trail for those checks becomes completely distorted, as they will carry the wrong deposit date. The Deposit Room's daily balancing can also be thrown into disarray by such uncorrected errors which occur after checks have been run and totals captured in the encoding machines. **The timely correction of errors is essential, and can only be accomplished when the Deposit Room personnel have the authority to remove or add approval levels.***

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**FINDING 02-KST1-22: The Office Of The Kentucky State Treasurer Should Ensure Significant Accounting Functions Are Adequately Separated To Reduce The Risk Of Errors (Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

*The most common scenario in making corrections occurs when a CR document crosses months. As an example, if a CR is approved by an agency with a date of October 31, but it does not arrive in the Treasury until November 1, it cannot be processed until the accounting period is changed to November. The Treasury Deposit Room staff, with their authority to remove and add approvals, can make this change in seconds. For the agency to make the change could take days, delaying the deposit and posting of the funds. This type of delay is unnecessary and unacceptable, and is easily prevented by giving the Deposit Room personnel the MARS authority necessary to make the needed changes.*

*There are several important points which must be kept in mind in considering the multiple levels of approval authority.*

- 1. The Deposit Room personnel do not add agency level approval to CR documents during ordinary processing. The Deposit Room personnel will contact agencies – oftentimes repeatedly – to have the necessary approvals applied, but until an agency brings a CR document to Pend 4 status in MARS, the deposit is not run. The only exceptions to this have been a few rare instances in which an agency deposit needed to be made, but the agency personnel were not available to add the necessary CR approvals. In these situations the agency has requested that Treasury staff add the necessary approvals to allow the deposit to post. Such requests are documented by the Treasury. The ability to respond to such emergency situations is another very strong example of why it is so essential that the Treasury Department Deposit Room personnel have multi-level approval authority for CR documents. It is of clear benefit to the Commonwealth. Prior to MARS, in the STARS accounting system, the Treasury Department staff had the authority to sign agency Pay-In-Voucher documents in the absence of the authorized agency personnel so that the deposits could be processed. The multi-level approval authority in MARS is merely an extension of this policy and authority that has been in place as long as anyone can remember.*

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**FINDING 02-KST1-22: The Office Of The Kentucky State Treasurer Should Ensure Significant Accounting Functions Are Adequately Separated To Reduce The Risk Of Errors (Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

2. *The Deposit Room personnel do not make changes in the body of a CR document, including the deposit amounts, without consulting the departments preparing the documents initially. When an error is discovered during processing, the agencies will be asked to make the changes immediately, or, if this is not feasible, to authorize the Treasury Department to make the necessary changes and to apply the new approvals. All changes are noted on the CR Transmittal Sheet retained by the Deposit Room, with the name of the person at the agency giving permission to make the changes.*
3. *The Deposit Room personnel will change the accounting period on a CR document that has crossed months without contacting the agency. There is no reason to contact the agency, since there are no options to discuss in these cases. A deposit cannot be made into a closed accounting period, and the only way to process the deposits is to change the accounting period information on the CR document to the current, open period.*

*Early in MARS, the Treasury tried to limit the multiple approval level for CR documents to one or two supervisory staff members. We quickly learned that this did not work. If those staff members were not present to aid in the correction of errors, the process bottle-necked the same as if no one in the office had that level of approval. It very quickly became evident that each Deposit Room staff person processing deposits needed to have all levels of approval for CR documents in order to complete their work in a timely manner. **This is a level of authority which must be maintained.** There is no indication that this authority has ever been abused, and the state has benefited by the timely processing of documents because of this ability. The Treasury Department is not willing to relinquish this approval authority for deposit documents. It is not in the best interests of the Commonwealth that we do so.*

*It is obviously the Auditor's concern that a Treasury employee will use this approval authority to either reduce or delete an on-line CR document and take whatever money is available. Our experience indicates that, even if the on-line record of a deposit were altered, most agencies retain enough documentation in other forms that they would realize that a deposit had been tampered with.*

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FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)

**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-KST1-22: The Office Of The Kentucky State Treasurer Should Ensure Significant Accounting Functions Are Adequately Separated To Reduce The Risk Of Errors (Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

*All agencies should maintain file copies of CR transmittals, and many have auxiliary documentation as well. The chance of an altered deposit going undetected is fairly remote.*

*One of the very basic principles behind the entire MARS system is the idea of "managed risk." This concept is not only a basis of MARS, but is an integral part of almost every modern day accounting and business management system. Many internal controls that have long been considered desirable have been modified or removed in order to enable businesses or governments to operate with fewer people. The entities accept a higher level of risk in exchange for lower operating costs, the hope being that any potential losses will be less than the costs that would be required to maintain the structure which would prevent those losses. This is the environment in which we now find ourselves. The Treasury Department acknowledges that, in theory, the suggestions made by the State Auditor in this comment could contribute to a more secure internal operation in the deposit function of the office. In practice, however, with the current staffing levels, the recommendations are not feasible. They add additional, time consuming steps to processes that are already stretched to the maximum, or they require additional personnel that are not available. In dealing with cash there is always a level of risk. We feel that, with the resources currently available to us, those risks have been minimized and are being managed. We must balance what is desirable with what is possible. We know and trust our staff, and we must provide them with the tools necessary to perform their jobs effectively. There are many controls in place, both within our office and in the MARS system itself, which provide a system of checks and balances on the deposit function. There will undoubtedly always be additional levels of control which can be implemented which would make the system even safer. However, those controls can be personnel intensive and costly, and, though desirable, may not be feasible. We feel that this is the case with many of these recommendations. They go beyond what is possible with current staffing and budgetary constraints.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-KST1-22: The Office Of The Kentucky State Treasurer Should Ensure Significant Accounting Functions Are Adequately Separated To Reduce The Risk Of Errors (Continued)**

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**Auditor's Reply**

Strong internal controls help to ensure tax dollars are used as directed by the citizenry and their elected officials. Although no internal control structure is 100% effective, it is the best defense to ensure that Kentucky tax dollars are used for intended purposes. The stronger the internal controls, the less likely that errors and fraud can occur.

During our audit of the cash handling procedures of Treasury, we discovered that the internal control structure had several weaknesses. We have listed these weaknesses in this finding, with the most important of these weaknesses being the lack of segregation of duties.

Separation of duty, as a security principle, has as its primary objective the prevention of fraud and errors. The general principles governing effective separation of duties can be summarized as follows:

- Separate custody of assets from accounting.
- Separate authorization of transactions from custody of related assets.
- Separate duties within the accounting function.
- Separate operational responsibility from record keeping responsibility.

The operational designs of the cash handling procedures of Treasury do not meet these principles. We have provided several recommendations to Treasury to help improve the internal control weaknesses. This list is not all-inclusive of possible solutions. We are willing to work with Treasury to improve areas of weakness.

Given the amount of funds handled on a daily basis and the importance of this function, we trust Treasury will give serious consideration to improving the control environment to reduce the risk of errors or loss and provide a secure area for safeguarding assets of the Commonwealth.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-CWD1-23: The Division Of Unemployment Insurance Is Not Reviewing Accounts And Declaring Them Uncollectible**

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State Organization: Cabinet for Workforce Development

During testing of delinquent employer account write-offs, we found that the Division of Unemployment Insurance (UI) did not perform any write-offs for FY 02. According to the Unemployment Insurance Tax Branch Manager, due to staff shortages, UI was unable to process any write-offs of delinquent accounts for tax collections for both FY 01 and 02. In response to the FY 01 finding, management indicated that Kentucky Electronic Workplace for Employment Services (KEWES) would implement a process to identify all accounts that are deemed uncollectible and, with proper authorization, automatically make the required change to the accounts to indicate the uncollectible status. During FY 02 testing, it was noted that KEWES was not currently performing this function.

When accounts receivable are not evaluated and written off in a timely manner, the receivables balance tends to be overstated.

Proper accounting procedures dictate receivables be evaluated periodically to determine the likelihood of collection and an amount that is likely to not be collected be written off. KRS 341.300 (4) states:

An action for the recovery of contributions, interest or penalties under this section shall be barred and any lien therefore shall be cancelled and extinguished unless collected or suit for collection has been filed within five (5) years from the due date of such contributions, except in the case of the filing of a false or fraudulent report the contributions due shall not be barred and may at any time be collected by the methods set out in this chapter, including action in a court of competent jurisdiction.

**Recommendation**

UI should:

- Establish a procedure to estimate a reasonable allowance for uncollectible accounts;
- Age accounts so that accounts over five (5) years and not in litigation are written off in a timely manner; and
- Implement procedures to ensure write-offs of uncollectibles are properly authorized.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-CWD1-23: The Division Of Unemployment Insurance Is Not  
Reviewing Accounts And Declaring Them Uncollectible (Continued)**

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**Management's Response and Corrective Action Plan**

*DES [Department of Employment Services] does acknowledge that reviews of accounts needing to be declared uncollectible were not done in fiscal year 6/30/2002. We are involved in several processes that will allow us to accomplish this objective during fiscal year 6/30/2003.*

*Programming by GOT has been completed to declare uncollectible accounts that are more than five years old. DES is in process of declaring which accounts are uncollectible. This should be completed by February 28, 2003.*

*As a result of legislative action allowing our agency funding for the purpose of establishing an electronic workplace, we have spent a great deal of time and effort on our KEWES project. A new design for declaring accounts uncollectible should be implemented prior to the end of fiscal year 6/30/2003. This process will daily identify those accounts where the delinquency is over five years old without a suit having been filed. These accounts will then be forwarded to the workbasket of a manager for the approval process. Once approval is made by a manager, the KEWES system will proceed with all necessary actions to move the account from collectible to uncollectible.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-CWD3-24: The Cabinet For Workforce Development Should Strengthen Controls Over Estimation Of Accounts Payable**

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State Organization: Cabinet for Workforce Development

During the auditors' test of reasonableness of the estimated accounts payable, we noted a material difference between amounts reported on the AFR-70 closing package form and the audited balance at June 30, 2002.

An accounting estimate that is unreasonable could cause the financial statements to be materially understated or overstated.

According to the *Codification of Statements on Auditing Standards* Section AU 342.13, "Review subsequent events or transactions. Events or transactions sometimes occur subsequent to the date of the balance sheet, but prior to the completion of fieldwork, that are important in identifying and evaluating the reasonableness of accounting estimates or key factors or assumptions used in the preparation of the estimate." The auditors must recognize that a difference between an estimated amount best supported by the audit evidence and the estimated amount included in the financial statements may be reasonable and that such differences would not be considered to be a misstatement.

**Recommendation**

The Cabinet for Workforce Development (CWD) should look at current unemployment benefits paid and any extended benefits to claimants to reasonably determine the current benefits that will be paid after fiscal year-end. CWD should reevaluate the computations presented on the Accounts Payable Estimate benefits form, since the amounts on this form are reported on the AFR-70 closing package form.

**Management's Response and Corrective Action Plan**

*DES attempts to make reasonable estimations based on the information available at the time AFR-70 is completed and due for inclusion in the closing package. However, more accurate information may become available during the time that the APA is conducting fieldwork. APA will be asked to provide additional guidance to assist DES personnel in making more accurate estimations in the future.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-CWD3-24: The Cabinet For Workforce Development Should Strengthen Controls Over Estimation Of Accounts Payable Liabilities (Continued)**

**Management's Response and Corrective Action Plan (Continued)**

*Pending further guidance from APA, the Benefit Payment Control Section will use actual figures from the Daily Check Register of payments made to claimants during the first week of July. Also, the actual figures from the Daily Check Register of payments made to claimants during the second week of July will be estimated at 50% of total checks paid. This action will be applied at this FYC [fiscal year closing]. See example below.*

*Example:       1<sup>st</sup> week payables (W/E 06-21-03 through W/E 06-28-03)  
                  2<sup>nd</sup> week payables (W/E 06-28-03 through W/E 07-05-03)*

**Auditor's Reply**

Since the submission of the CWD's response and corrective action plan, the auditors have met with CWD personnel to discuss this finding. CWD has found a different approach to providing the information needed to prepare the closing package. DES has concluded that they have the necessary information prior to submission of the closing package form to enable them to present a more reasonable estimate.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-CWD4-25: The Cabinet For Workforce Development Should Strengthen The Security Of Administrator Accounts**

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State Organization: Cabinet for Workforce Development

Vulnerability testing of CWD servers revealed several instances of lax security over administrator accounts, resulting in the potential of servers being vulnerable to intrusion.

We examined 22 CWD servers that provided NetBIOS information and found the administrator accounts on all 22 servers had not been renamed or disabled. Since the administrator cannot be locked out, if the account is not renamed, the server could be vulnerable, if a potential intruder attempted to gain access by guessing the administrator password through a brute force attack.

Further, we examined the CWD servers for specific applications that could be vulnerable and found six (6) machines with port 1433 open. One (1) server allowed the auditors to gain “Master” access through SQL using the default administrator logon. This type of access would provide an unauthorized user with complete access to the application. In addition, the user would be granted local system account rights to the server on which the application resides.

Administrator accounts are very powerful and can allow full access to the system. Therefore, these accounts should be scrutinized to ensure they are adequately secured. At a minimum, the passwords for these accounts should be changed from the system defaults. Further, some administrator accounts can be renamed to help obscure them from an unauthorized user’s view.

**Recommendation**

We recommend CWD review all servers to ensure the local administrator accounts have been changed from the default-naming conventions and require the use of a password. Further, all applications that might allow a user access to the system or to configuration settings should be reviewed to ensure default logons are not allowed.

**Management’s Response and Corrective Action Plan**

*We have checked all of our servers. All of the Administrator accounts have been changed from the default naming conventions and require the use of a password. We are in the process of reviewing all applications that might inadvertently allow a user to access the system or permit access to configuration settings to ensure that default logons are not allowed. We plan to be in compliance by June 30, 2003.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

***Material Weaknesses and/or Material Instances of Noncompliance:***

**FINDING 02-CPE3-26: The Council On Postsecondary Education Should Implement Additional Procedures To Ensure Information Required For The Professional Education Preparation Program Is Requested If Not Received In A Timely Manner**

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State Organization: Council on Postsecondary Education

The Memorandum of Understanding between the Council and institutions receiving funds through the Professional Education Preparation Program requires an annual report be submitted by October 31 following the fiscal year end certifying expenditure and use of funds distributed. The University of Kentucky did not submit a timely report for FY 01.

The Council was not able to verify that the funds were expended as intended.

The procedures in place did not include follow-up procedures to request information not received in a timely manner.

**Recommendation**

The Council should implement additional procedures, including the implementation of a tickler system, to ensure that the required information is requested if not received in a timely manner.

**Management's Response and Corrective Action Plan**

*The council staff agrees with the finding. A tickler system will be implemented by December 31, 2002 for all programs and activities where reports are required. Last year, a policy was introduced requiring that, where reports are overdue, no disbursements of funds be made until the required report is submitted. No funds were disbursed until the University of Kentucky report was received. The Council will continue to work with the institutions to ensure effective compliance.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-CPE4-27: The Council On Postsecondary Education Should Consider Additional Procedures to Ensure Information Required For The Minority Student College Preparation Program Is Received In A Timely Manner**

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State Organization: Council on Postsecondary Education

The Memorandum of Understanding between the Council and institutions receiving funds through the Minority Student College Preparation Program requires an annual report be submitted by July 30 following the fiscal year end certifying expenditure and use of funds distributed. The University of Louisville has not submitted a report for FY 01.

The Council was not able to verify that the funds were expended as intended.

The procedures in place did not include follow up procedures to request information not received in a timely manner.

**Recommendation**

The Council should consider additional procedures to ensure the tickler system implemented following the 2000-01 audit is sufficient to ensure that required information is received in a timely manner.

**Management's Response and Corrective Action Plan**

*The council staff agrees with the finding. One grant recipient did not provide a financial report in a timely manner. A tickler system is in place. Institutions are informed in the MOA [Memorandum of Agreement] of the deadlines for reports, and institutions are notified by phone or e-mail when a report is late. In the instance where the one report was late last fiscal year, the institution did inform us that the report would be late. The circumstances of the delay in submitting the report involve the implementation of a new financial resources system. The council staff believes the procedures in place are adequate. Consistent with council practice, no FYE 2002 funds will be released to the University of Louisville until the FYE 2001 report is received. No additional action will be taken.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
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(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-CPE5-28: The Council On Postsecondary Education Should Implement Additional Procedures To Ensure Information Required For The Kentucky Educational Excellence Scholarship Program Is Requested If Not Received In A Timely Manner**

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State Organization: Council on Postsecondary Education

The Memorandum of Understanding between the Council and the Kentucky Department of Education (KDE) and KHEAA requires an annual accounting of administrative funds disbursed under the Kentucky Educational Excellence Scholarship (KEES) program to KDE and KHEAA, with a return of any unused funds to the Council. Neither the refund from KHEAA nor the accounting from KDE were received in a timely manner. A refund from the KDE has not been received. This condition was present in a prior year finding related to KDE only.

The Council was not able to verify that the funds were expended as intended or if any funds should have been returned.

The procedures in place did not include follow-up procedures to request such information not received in a timely manner.

**Recommendation**

The Council should implement additional procedures, including the implementation of a tickler system, to ensure that the required information is requested if not received in a timely manner.

**Management's Response and Corrective Action Plan**

*The council staff agrees with the finding. A tickler system has been implemented. Both KHEAA and the KDE will be notified one month prior to the due date of the report. Council staff will meet with the KDE financial staff to ensure that the proper officials are aware of the need to file the report by date certain and to process any refund that is due. The council staff will review the joint MOA and probably will change the due date for any refund to allow the agencies time for processing after the end-of-year closing.*

**COMMONWEALTH OF KENTUCKY  
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FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-CPE6-29: The Council On Postsecondary Education Should Investigate Alternatives To Address The Apparent Inconsistency Between The Current Council Guidelines And The Current Provision Of KRS 164.7919(1)(c)**

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State Organization: Council on Postsecondary Education

Per review of Endowment Match Program supporting documentation, endowments matched from the Regional University Excellence Trust Fund were not limited to the university-selected area of concentration, as also noted in a prior year finding. KRS 164.7919(1)(c) states that the purpose of the Regional University Excellence Trust Fund is to “encourage regional universities to develop at least one nationally recognized program of distinction or one nationally recognized applied research program. . .” However, the guidelines do not require matching in any specific area, but permit endowment matching regardless of the discipline.

The Council’s disbursal of funds was not in compliance with KRS 164.7919(1)(c).

We understand that, at the time KRS 164.7919 was codified into law, funding for programs of distinction and nationally recognized applied research programs was appropriated through the Council’s Regional University Excellence Trust Fund. We also understand that, beginning with the 1999-2000 biennium, it is the Council’s understanding that all funding for programs of distinction and nationally recognized applied research programs is now appropriated directly to the institutions. Accordingly, the Council’s guidelines do not require matching in the university-selected areas of concentration and, therefore, the guidelines do not appear to be in accordance with the current provisions of KRS 164.7919(1)(c).

**Recommendation**

We recommend the Council investigate alternatives to address the apparent inconsistency between the current Council guidelines and the current provision of KRS 164.7919(1)(c). Alternatives to consider include (1) pursuing legislative update to KRS 164.7919(1)(c); (2) request that future appropriation bills specify the purpose of the current funding appropriated through the Regional University Excellence Trust Fund; or (3) revise the Council guidelines to comply with the provisions of KRS 164.7919(1)(c).

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-CPE6-29:** The Council On Postsecondary Education Should Investigate Alternatives To Address The Apparent Inconsistency Between The Current Council Guidelines And The Current Provision Of KRS 164.7919(1)(c)  
(Continued)

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**Management's Response and Corrective Action Plan**

*The Council staff agrees that there is a need to clarify the language of KRS 164.7919(1)(c) or the appropriations bill language authorizing the endowment match program. Kentucky operates on a biennial cycle with the 2001-02 audit covering the second year of the biennium. Because the 2001-02 appropriation was already set, no changes in language were considered. The council did discuss changes with the Office of the State Budget Director in the context of the 2002-04 budget, but since no budget was approved, no change was possible. If the Kentucky General Assembly adopt a budget for 2003-04, the Council again will request that clarifying language be added to the appropriations bill.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
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(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-CPE7-30: The Council On Postsecondary Education Should Revise  
The Guidelines Applicable To The Regional University Excellence Trust Fund**

State Organization: Council on Postsecondary Education

Per review of Endowment Match Request Forms, endowments matched from the Regional University Excellence Trust Fund were not limited in the areas of arts and humanities. This finding was also noted in the prior year. The Council-approved guidelines recognize that arts and humanities add to quality of life and permit a limited amount of matching in these areas. However, the term “limited” is not defined and, in practice, the Council did not limit the amount of endowment matching funds in these areas.

The Council’s disbursement of funds may not be in accordance with the Council-approved guidelines.

The Regional University Excellence Trust Fund guidelines do not clearly define the amount of matching that will be permitted in the areas of arts and humanities, resulting in the practice that the Council did not limit the amount of endowment matching funds in these areas.

**Recommendation**

The guidelines applicable to the Regional University Excellence Trust Fund should be revised to more clearly define the amount of matching that will be permitted in the areas of arts and humanities.

**Management’s Response and Corrective Action Plan**

*The council staff agrees that the absence of parameters on what “limited” means makes it difficult to measure whether the Council is, in fact, limiting the amount of funds at the comprehensive institutions that is dedicated to the humanities. The Council staff will provide the Council with the percentage of endowment awards for each institution that is dedicated to humanities and will discuss delimiting language that allows us to ensure compliance.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
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(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-REV3-31: The Kentucky Revenue Cabinet Should Have A System In Place To Reconcile Critical Information**

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State Organization: Kentucky Revenue Cabinet

The Revenue Cabinet does not have a system in place to input or reconcile critical information to the mainframe system; this continues to be a problem for Revenue, as this has been reported during prior year audits. Thus, Revenue cannot be sure that reported amounts remitted are correct. While Revenue currently has a reconciliation project underway, there was no system in place at the time of our audit.

The Revenue Cabinet should have adequate systems in place to ensure all taxes due to Kentucky have been collected and all taxpayers are reporting key information in compliance with Commonwealth laws.

**Recommendation**

The Revenue Cabinet should develop a system for reconciling critical information.

**Management's Response and Corrective Action Plan**

*KRC agrees with the audit findings. Programming is underway to create a system, which will identify exceptions in the amounts reported by taxpayers. It is expected that some data will be available to begin activity in late February 2003. However, modifications will in all probability be necessary to the system as the program evolves. Until this system is fully implemented, any attempt to perform the reconciliation will be primarily in a manual environment and extremely labor intensive. Some aspects of this system are now functional with assessment activity being performed.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
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(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-CWD2-32: The Division Of Unemployment Insurance Should Have A Computer System In Place To Adequately Maintain Employer Accounts**

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State Organization: Cabinet for Workforce Development

During testing of 105 delinquent employer contribution receivables and 56 deferred revenues, we discovered 95 that had the following errors:

- The Kentucky Employer's Quarterly Unemployment Insurance Tax and Wage Reports (UI -3) were posted without payment via electronic filing by employers that are called tape filers, which created a receivable; however, the payment was received timely, but was not posted into the Unemployment Insurance – Administration (UIA) Program 42 system until after June 30, 2002.
- Several employer accounts were either bankrupt or voided (inactive) and should not be considered as a receivable.
- Payments were posted as accounts payable and not to the quarterly return it applied to, which also created a receivable in the system. Also payments were posted to accounts payable that did not have a corresponding return in the system. However, upon further investigation, the return was found to have been received and in the KEWES system, but not posted to the employer's account in the Program 42 system.
- Wages were incorrectly read by the MFE system, and, when posted to the UIA Program 42 system, it incorrectly created a receivable.
- The employer paid the correct lower rate; however, the rate was not changed in the system.
- Amended returns were posted as receivables, instead of making journal entries to correct the original return.
- In some cases, the receivable or deferred revenue was no longer showing on the system. We noted that several people have the capability to make adjustments to employer accounts without an audit trail.

Furthermore, on the AFR 30 and 32 closing package forms, the agency did not use its Trial Balance of Employer Accounts to report the amount received, not earned (deferred revenue) as of June 30, 2002.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
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(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-CWD2-32: The Division Of Unemployment Insurance Should Have A Computer System In Place To Adequately Maintain Employer Accounts (Continued)**

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We cannot rely on the UIA Program 42 system to provide accurate reports related to employer tax, including a Trial Balance of Delinquent Contributions.

An overstatement of receivables from delinquent employer contributions on the closing package forms in the amount of \$46,550,188 was reported to FAC and was posted into the MARS system for financial statement reporting.

The deferred revenue amount was not supported with verifiable information; however, an adjustment was not made because the amount reported on the closing package form was reasonable based on our testing.

Proper internal control dictates UI should have a computer system in place to adequately maintain employer accounts to ensure that information input into the system is accurate and reliable.

Generally Accepted Accounting Principles (GAAP) dictates that government funds recognize revenues in the accounting period in which they become susceptible to accrual – both measurable and available. Therefore, amounts that are available, but not otherwise measurable, should be reported as deferred revenue rather than as revenue.

**Recommendation**

Computer system and staff controls should be enhanced to ensure amounts reported on the closing package forms for financial statement purposes are accurate and reflect the correct employers account balances. Corrections to computer systems and additional system controls must be implemented to prevent the recurrence of programming errors that affect the employer accounts. The closing package form submitted by UI must be supported by balanced and verifiable documentation.

**Management's Response and Corrective Action Plan**

*DES is very concerned about accurate records. It would be irresponsible for the agency to allow known errors to remain uncorrected; therefore, we are requesting a detailed list and any documentation pertaining to the 95 errors on employer contribution reports referenced by the auditor. Also, in an attempt to better understand the auditor's findings, DES is requesting a breakdown of each error found. DES is anxious to get these accounts corrected.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-CWD2-32: The Division Of Unemployment Insurance Should Have A Computer System In Place To Adequately Maintain Employer Accounts (Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

*Each of the bullets that the auditor noted are addressed below based on the information available from the bullets.*

- 1. To help alleviate the problem of magnetic media Tax and Wage Reports (UI-3) being posted without payment which creates a receivable; the Branch is sending the checks to Revenue for processing and submission to the UIA database prior to submitting the wage and tax report data. However, this will not alleviate A Notice of Assessment creating for those employers using our Website to submit their wage and tax report. This is due to the programming that is currently in place. The agency would like to initiate a M-3 request to program a stopgap measure for the short term, but in the long term, providing the funding becomes available, a major programming and system rewrite will be necessary. Most current processes would have to be changed and linked to the KEWES system.*
- 2. Being void or bankrupt alone does not cause an account to cease being receivable. There is a list of criteria that must be met. Under the new process, any account, upon meeting the prescribed criteria, automatically becomes "pending uncollectible". This creates an activity for supervisor approval. Upon approval by the supervisor, the account becomes uncollectible and is removed from accounts receivable reports.*
- 3. If a payment is received with no report, or if that employer owes no money to this agency, it is processed as an overpayment and not assigned to any specific quarter. However, if after processing the overpayment the employer files a report where money is due, that overpayment will automatically be applied to the filed report and tied to that quarter/year.*
- 4. In the instances of the MFE system reading the tax data incorrectly and creating a payable and/or receivable the agency inserted an edit to the UIA database to ensure that payments are properly applied. Any reports failing these edit are returned to KEWES and place into workflow queues (inbox) for review.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 02-CWD2-32: The Division Of Unemployment Insurance Should Have A Computer System In Place To Adequately Maintain Employer Accounts (Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

*5. DES is requesting the employer's KEIN [Kentucky Employer Identification Number] for investigation and possible corrective action will be taken. The Agency understands that computer system controls should be enhanced to ensure amounts reported for financial statements purposes are accurate and reflect the correct employers account balances.*

*6. Employers are instructed to mail amended reports to a different P.O. Box, which is processed by the Department for Unemployment Insurance rather than the Revenue Cabinet. Additionally, the Revenue Cabinet has been requested to send any amended reports they receive to DES for processing. However, if an employer sends an amended report to Revenue and it is processed as an original report, it will automatically go into the "Contributory" queue in KEWES for review. Any employer with more than one report for the same quarter will end up in this queue for review.*

*7. There are several employees who have "on-line" ability to make corrections to accounts. No one has the ability to make a change without an audit trail. Any change made on the status screen of 42 (address, rate) creates a "Notice of Change". Any change made on the account receivable screen is reflected on a monthly report which shows the change that was made and the user ID of the person who made the change.*

*DES will continue to educate and work with staff and KRC (Kentucky Revenue Cabinet) to ensure the accurate processing of UI Tax Receipts.*

**Auditor's Reply**

The auditors have provided DES with the specific documentation that was requested relating to our sample tested. We also would like to note that the new process that was discussed relating to void or bankrupt accounts that are deemed uncollectible was not in place during this audit period and will be looked at for the next fiscal year. As for the audit trail, we inquired and searched for the audit trail relating to specific adjustments during testing, but UI was unable to provide us with that information.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

***Reportable Conditions Relating to Internal Control and/or Reportable  
Instances of Noncompliance:***

**FINDING 02-CFC12-33: The Cabinet For Families And Children Should Develop A  
Policies And Procedures Manual To Ensure Subrecipient Monitoring Is Properly  
Performed**

State Agency: Cabinet for Families and Children

Federal Program: CFDA 17.253 – Welfare-to-Work Grants to States and Localities

CFDA 93.563 – Child Support Enforcement

CFDA 93.575 – Child Care and Development Block Grant

Federal Agency: U.S. Department of Labor

U.S. Department of Health and Human Services

Pass-Through Agency: Not Applicable

Compliance Area: Subrecipient Monitoring

Amount of Questioned Costs: None

CFC contracts with local not-for-profit organizations, community action agencies, and county attorneys to provide services to needy families. Program deficiencies were noted regarding Welfare-to-Work (WtW), Child Support Enforcement (CSE), and Child Care and Development Block Grant (CCDBG). As subrecipients of federal awards, organizations that expend in excess of \$300,000 are required to have a single, or program-specific, audit in accordance with OMB Circular A-133.

Audits of subrecipients must be submitted to CFC for review within the earlier of 30 days after receipt of the auditor's report(s) or nine (9) months after the end of the audit period. We requested monitoring reports, subrecipient contracts, and audit reports to test CFC's compliance with OMB Circular A-133 provisions. We noted three (3) subrecipients failed to submit an audit report to CFC for FY 01. Desk reviews for FY 01 audits have not been performed for 10 subrecipients. During the contract monitoring testing, one (1) subrecipient was missed in the monitoring process for FY 02.

CFC has not taken the appropriate steps to correct similar problems that were noted during prior years. Deficiencies noted during our testing follow:

<b>CFDA #</b>	<b>Subrecipient</b>	<b>A-133 Audit Deficiency</b>
17.253 WtW	Barren River Area Development District (ADD)	Desk review for 2001 audit not performed.
	Lake Cumberland ADD	Desk review for 2001 audit not performed.
	Bluegrass ADD	Desk review for 2001 audit not performed.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
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(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-CFC12-33: The Cabinet For Families And Children Should Develop A Policies And Procedures Manual To Ensure Subrecipient Monitoring Is Properly Performed (Continued)**

<b>CFDA #</b>	<b>Subrecipient</b>	<b>A-133 Audit Deficiency</b>
93.563 CSE	Big Sandy ADD	Audit for 2001 was not submitted.
	Institute of Family Centered Services	Audit for 2001 was not submitted.
	Northern Kentucky ADD	Audit for 2001 was not submitted.
	University of Louisville Research Foundation	Desk review for 2001 audit not performed.
	Kentucky Community and Technical College System	Desk review for 2001 audit not performed.
	Green River ADD	Desk review for 2001 audit not performed.
	University of Kentucky Research Foundation	Desk review for 2001 audit not performed.
	Jefferson County Community Development	Desk review for 2001 audit not performed.
93.575 CCDBG	Eastern Kentucky Child Care Coalition	Desk review for 2001 audit not performed.
	Kentucky Association of Child Care Resource and Referral Agencies	Desk review for 2001 audit not performed.

<b>CFDA #</b>	<b>Subrecipient</b>	<b>Contract Monitoring Deficiency</b>
93.563 CSE	F.M. Blake	Monitoring was not performed for subrecipient.

CFC cannot be assured that subrecipients are expending federal awards for their intended purpose and complying with the requirements of OMB Circular A-133 without having proper monitoring procedures in place.

OMB Circular A-133, Subpart B states: “[n]on-Federal entities that expend \$300,000 or more in a year in Federal awards shall have a single or program-specific audit conducted for that year in accordance with the provisions of this part.”

CFC has the following responsibilities under OMB Circular A-133, Subpart D (d):

- 1) Advise subrecipients of requirements imposed on them by federal laws, regulations, and provisions of contracts or grant agreements as well as any supplemental requirements imposed by the pass-through entity.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-CFC12-33: The Cabinet For Families And Children Should Develop A Policies And Procedures Manual To Ensure Subrecipient Monitoring Is Properly Performed (Continued)**

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- 2) Ensure required audits are performed and require subrecipients to take prompt corrective action on any audit findings; and,
- 3) Evaluate the impact of subrecipient activities on the pass-through entity's ability to comply with applicable federal regulations.

The Commonwealth of Kentucky Master Agreement, which is the contract between CFC and CHS, Office of Inspector General (OIG), states that OIG will: 1) Perform reviews and audits to ensure financial compliance with state and federal laws and regulations and evaluate external audits performed for CFC, and perform other related services. 2) Complete desk reviews of A-133 audits within six (6) months of receipt. 3) Meet the standard 100% of the time.

OMB Circular A-133 §\_\_\_\_.225 states;

[n]o audit costs may be charged to Federal awards when audits required by this part have not been made or have been made but not in accordance with this part. In cases of continued inability or unwillingness to have an audit conducted in accordance with this part, Federal agencies and pass-through entities shall take appropriate action using sanctions such as:

- (a) Withholding a percentage of Federal awards until the audit is completed satisfactorily;
- (b) Withholding or disallowing overhead costs;
- (c) Suspending Federal awards until the audit is conducted; or
- (d) Terminating the Federal award.

**Recommendation**

We again recommend a policies and procedures manual be developed to make the subrecipient monitoring process more effective and easier to follow. It would also ensure compliance with OMB Circular A-133 subrecipient monitoring compliance requirements. In particular, OMB Circular A-133 requires the pass-through entity (CFC) to receive audit reports from subrecipients required to have an audit in accordance with OMB Circular A-133 and issue "timely" management decisions on audit and monitoring findings. Also, it requires subrecipients to take "timely" corrective action on deficiencies identified in audits and subrecipient

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
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**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-CFC12-33: The Cabinet For Families And Children Should Develop A Policies And Procedures Manual To Ensure Subrecipient Monitoring Is Properly Performed (Continued)**

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**Recommendation (Continued)**

monitoring. OMB Circular A-133 does not specify what “timely” means; however, a CFC subrecipient monitoring policies and procedures manual could define that to ensure compliance and consistency.

The written policies and procedures should contain, at a minimum, the following:

- 1) Communication of federal award requirements to the subrecipients.
- 2) The responsibilities for monitoring and tracking subrecipients in a timely manner, with a definition of what “timely” means. An example would be to have deadlines for the response on each correspondence sent to the subrecipient and/or independent auditor. After a maximum number of sent correspondence, such as three (3), the file would be forwarded to general counsel for pursuit of noncompliance items.
- 3) Specific monitoring processes. An example would be to better use the CFC Audit Log for OIG, perhaps through weekly updates.
- 4) Methodology for resolving the findings of subrecipient noncompliance or weaknesses in internal control and a timeline for corrective action.
- 5) Requirements for processing subrecipient audits, including appropriate adjustment of pass-through entity’s accounts, such as through the sanctions mentioned above.
- 6) Require CHS/OIG to be compliant with the six (6) months turnover of desk reviews as required by the CFC contact.

**Management’s Response and Corrective Action Plan**

*Beginning in January 2002, the Contracts Management Branch assigned a staff person to devote a portion of her time to managing the audits submitted to the CFC. As time permitted, this individual developed a log to track letters of engagement, management letters, and audits; sent reminder letters to vendors; and drafted a shell for the proposed policy and procedure manual. It became apparent that the job required more than a portion of one employee’s time. Therefore, CFC recently employed a staff person whose time is devoted to managing the audit review process. This individual, a Certified Public Accountant (CPA), will fully develop a policy and procedure manual and manage all aspects of receiving and processing audits.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
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**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-CFC12-33: The Cabinet For Families And Children Should Develop A Policies And Procedures Manual To Ensure Subrecipient Monitoring Is Properly Performed (Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

*The policy and procedures manual will address, at a minimum, the six items listed in the auditor's correspondence. The contract language concerning audits is being reviewed and will be strengthened in the FY04 contracts. Currently, letters are sent to vendors reminding them that the contract audit requirements specify their submitting letters of engagement by March 31, 2003 and audit reports and Management Letters no later than March 31, 2004.*

*In cases where CFC is not the cognizant agency, CFC has relied on the cognizant agency to review the audits and inform CFC of problems. This practice will be reviewed and revised to provide more direct oversight of the subrecipients' activities.*

*Additionally, the Contracts Monitoring Branch will ensure that non-Federal entities that expend \$300,000 or more in federal funds in a year are listed for review.*

*The Contracts Monitoring Branch was short staffed in 2002. The Branch has had four (4) of its fifteen (15) full – time monitoring positions vacated and not replaced in the past year. In addition, several of the eleven (11) remaining monitors the Branch does have are new hires who have had to be trained and have been unable to take on full monitoring contract loads this past year. Therefore, while the F. M. Blake Contract Monitoring had been assigned and attempts had been made to schedule it, the Branch did get behind and did not perform the FY 02 Monitoring by December 31, 2002. It is our understanding that this was the sole finding of deficiency for FY 02 that relates to this branch.*

- 1. The FY 2002 Contract Monitoring of F. M. Blake is scheduled for February 26, 2003 and will be conducted by interim contract monitors.*
- 2. In December 2002, the Contracts Monitoring Branch began work on a Policy and Procedures Manual. The manual will include administrative and procedural matters, including specific monitoring processes. All staff are currently taking part in working on the manual. In the interim, the following corrective measures have also been taken:*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
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**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-CFC12-33: The Cabinet For Families And Children Should Develop A Policies And Procedures Manual To Ensure Subrecipient Monitoring Is Properly Performed (Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

- a. The Branch has developed a series of form letters to be used by all monitors that cover such things as setting appointments, sending the monitoring report, corrective action plans, etc. The letters do advise the vendors of deadlines and consequences of non-responsiveness, etc. For example, the letter requesting the third request for corrective action plan will now be sent by the Contracts Monitoring Branch Manager, with copies advising the Contracts Management Branch Manager, the Division of Program Integrity Director, and the affected Program Division Manager.*
- b. There have been some problems with getting appointments set for certain contract monitoring. In order to try to avoid that problem in the future, the Contracts Monitoring Branch has developed form letters to handle setting appointments.*
- c. The CFC Contract Monitoring Tracking Log has been revised.*
- d. Contract Monitoring assignments are generally made twice a year (in January and June). In the past, contract monitoring assignments just needed to be completed by the end of either December or June. In an effort to ensure that all Contract Monitoring assignments get completed on time, the policy was changed in December 2002. The Branch is trying out a new system where staff is expected to complete half of their contract monitoring assignments by the midpoint of their assignment period.*
- e. The Contracts Monitoring Branch is trying out a revised fiscal monitoring tool which collects, where applicable, copies of vendors' audit reports.*
- f. A Checklist of documents has been prepared to assist the staff assistant so she will know what needs to be included in every monitoring report folder that is kept in the central office.*
- g. A new policy has been put in place requiring monitoring reports to be reviewed prior to being sent out to vendors.*
- h. The branch will be implementing a new policy regarding how final monitoring reports and required letters must be put on the Contracts Monitoring Branch computer system.*
- i. The Contracts Monitoring Branch Manager is currently taking part in providing Cabinet wide training led by the Contracts Management Branch to educate the CFC Division Directors and their representatives to better understand the process of requesting, seeking approval of and monitoring CFC contracts.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
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(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-CFC12-33: The Cabinet For Families And Children Should Develop A Policies And Procedures Manual To Ensure Subrecipient Monitoring Is Properly Performed (Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

- j. The Contracts Monitoring Branch has prepared a Power Point Training Presentation to educate CFC Program staff on how the Branch prepares Contract monitoring tools and how the Branch may be able to assist CFC Program staff to monitor vendor contractual weaknesses.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-CFC14-34: The Cabinet For Families And Children Should Monitor Cases Closely So An Ineligible Recipient Does Not Receive Additional Months Of Benefits**

State Agency: Cabinet for Families and Children

Federal Program: CFDA 93.558 – Temporary Assistance for Needy Families

Federal Agency: U.S. Department of Health and Human Services

Pass-Through Agency: Not Applicable

Compliance Area: Activities Allowed/Unallowed and Eligibility

Amount of Questioned Costs: \$2,616

The Federal Personal Responsibility and Work Opportunity Reconciliation Act (PRWOA) of 1996 (Public Law 104-193, as amended) mandated a maximum lifetime limit on welfare benefits for 60 months, with the first discontinuances beginning October 2001, which is within FY 02. Some households that were scheduled to have their benefits discontinued may have received special hardship exemptions and may continue to receive all or a portion of their Temporary Assistance for Needy Families (TANF) cash assistance for as long as the hardship lasts.

We tested a sample of 25 TANF recipients that were approaching the 60-month lifetime limit on receiving TANF benefits to ensure benefits were discontinued at the end of the 60-month period, or that reasons for extending funding were valid. We found three (3) instances where clients received over 60 months of benefits they were not eligible to receive:

<b>Case number</b>	<b>Number of ineligible months</b>	<b>Monthly benefit amount</b>	<b>Ineligible amount client received</b>
1	5	\$ 328	\$ 1,640
2	1	\$ 210	\$ 210
3	2	\$ 383	\$ 766
		<b>Total</b>	<b>\$ 2,616</b>

When CFC fails to discontinue benefits to TANF recipients that have reached the 60-month lifetime limit, clients receive additional money that they are not entitled to, which may prevent eligible recipients from receiving benefits due to the limited funds available.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-CFC14-34: The Cabinet For Families And Children Should Monitor Cases Closely So An Ineligible Recipient Does Not Receive Additional Months Of Benefits (Continued)**

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The OMB A-133 Compliance Supplement for CFDA 93.558 Part III. E.1.b. (1) states, “Any family that includes an adult or minor child head of household or a spouse of the head of household who has received assistance under any State program funded by Federal TANF funds for 60 months (whether or not consecutive) is ineligible for additional federally funded TANF assistance.”

PRWOA Section 408 (a) (7) (A) states:

NO ASSISTANCE FOR MORE THAN 5 YEARS – IN GENERAL – A State to which a grant is made under section 403 shall not use any part of the grant to provide assistance to a family that includes an adult who has received assistance under any State program funded under this part attributable to funds provided by the Federal Government, for 60 months (whether or not consecutive) after the date the State program funded under this part commences . . .

TANF Final Rule Executive Summary states, “In general, States may not use Federal Funds to provide assistance to a family if it includes an adult or minor head-of-household or the spouse of a head-of-household who has received assistance for a cumulative total of more than 60 months.”

Kentucky TANF Title IV-A State Plan – July 2001 states, “Five year lifetime limit for families with an adult.”

**Recommendation**

We recommend CFC remind staff of the importance of closely monitoring each case so that an ineligible recipient does not receive additional months of benefits to which they are not entitled.

We discovered several recipient files that were very well documented and benefits were properly discontinued; however, since other files were deficient, we recommend staff provide adequate documentation in the recipient files and observe all policy and procedures regarding this issue.

Any funds discovered that were issued in error should be recouped, if at all possible. CFC should reimburse the federal government for the questioned costs noted.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-CFC14-34: The Cabinet For Families And Children Should Monitor Cases Closely So An Ineligible Recipient Does Not Receive Additional Months Of Benefits (Continued)**

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**Management's Response and Corrective Action Plan**

*60 month discontinuance and/or 20% hardship was discussed at our last staff meeting on February 6, 2003. We are now monitoring the 36-month and 60-month extension reports. The supervisor for DCBS [Department of Community Based Services] is now monitoring all 60-month discontinuances for DCBS, Community Action Council and the Family Care Center. Claims will be processed for over payments noted on this report.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-CFC15-35: The Cabinet For Families And Children Should Maintain And Produce Records to Adequately Support Expenditures**

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State Agency: Cabinet for Families and Children

Federal Program: CFDA 93.558 – Temporary Assistance for Needy Families

Federal Agency: U.S. Department of Health and Human Services

Pass-Through Agency: Not Applicable

Compliance Area: Activities Allowed/Unallowed and Eligibility

Amount of Questioned Costs: Not Applicable

We tested a sample of 45 payments to participants in the TANF program. CFC failed to produce records to support expenditures and follow the PA-32 Procedural Instructions, which are a part of the Community Based Services Forms Manual, for some of the sampled items. The instructions include detailed descriptions of how PA-32s should be completed by caseworkers.

We noted the following weaknesses:

- Recipient files were missing for two (2) of 45 cases tested,
- PA-32s were missing from files in seven (7) cases,
- Incomplete PA-32s in one (1) case (Unused Lines not X'd out on form), and
- Employment retention payments not supported by receipt or invoice in two (2) cases.

CFC has not taken adequate measures to correct this problem, as similar problems were noted in the FY 01 audit. However, there has been significant improvement, and CFC should be commended for its efforts toward correction of this problem.

CFC cannot be assured that all payments for both recurring and nonrecurring expenses were valid. Also, if PA-32s are not completed according to instructions, the potential for fraud and misuse of funds exists.

Federal Regulations at 45 CFR 92.20(a)(2), state, “[f]iscal control and accounting procedures of the State . . . must be sufficient to . . . permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes.”

Federal Regulations at 45 CFR 92.42(b)(1), also state, “. . . records must be retained for three years from the starting date specified in paragraph C.”

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
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(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-CFC15-35: The Cabinet For Families And Children Should Maintain And Produce Records to Adequately Support Expenditures (Continued)**

CFC DCBS Operation Manual Transmittal Letter number 239, Volume III, 3800-3899 Employment Retention Services, Section 3825 DETERMINING EMPLOYMENT RETENTION ASSISTANCE, (ERA) ELIGIBILITY, states, “To receive ERA, a family must request payment and return verification of a short term need that will allow for continued employment and they must have sufficient benefits remaining.”

Good internal controls dictate that procedures be followed to ensure that payments are made only for approved and allowable goods and services.

**Recommendation**

We recommend CFC remind staff of the importance for maintaining participant case files. Records should be produced and maintained to adequately support expenditures. The PA-32 forms should be completed according to instructions in all cases.

**Management’s Response and Corrective Action Plan**

- *PA-32’s are now logged in by clerical staff that opens mail and then given to the case manager for payment. The local office had already identified this as a problem and corrective action had already been initiated.*
- *Training has been provided to staff on the use of PA-32’s for car repairs and insurance and stressed that both forms are required even when payments are made to the client. Reminded staff to XXX through lines on PA-32 that are not used.*
- *ERA policy was reviewed with the importance of receipts stressed in documenting how payments were utilized.*

*Local office has been having some issues with filing, which has resulted in files being placed in file cabinets incorrectly and they feel that the filing has improved and will continue to work toward finding files that have been misfiled.*

*We will have mini-training for DCBS, Community Action Council and Family Care Center staff on completion of PA32’s, maintaining files and transferring of files. ERA is no longer a factor after 3/31/03 however; supervisor will closely monitor all ERA payments and stress to all staff the importance of filing actions in the case records.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-CHS12-36: The Division Of Program Integrity Has A Large Outstanding Balance Of Accounts Receivable For The Drug Rebate Program**

State Agency: Cabinet for Health Services

Federal Program: CFDA 93.778 – Medical Assistance Program

Federal Agency: U.S. Department of Health and Human Services

Pass-Through Entity: Not Applicable

Compliance Area: Allowable Costs/Cost Principles

Amount of Questioned Costs: None

Historically, the Division of Program Integrity has not actively sought payment on accounts receivable aged over 60 days. The Compliance Supplement requires manufacturers to pay rebates to the State within 30 days or provide written notice of disputed items not paid due to discrepancies. The division sends a notice to delinquent drug manufacturers after 38 days. Another notice is sent after 60 days to request payment or reason for amount disputed. After the second notice is sent, there are no other formal attempts at settlement. The current director and his staff have been more active, but there still remains a large amount of accounts receivable outstanding.

There have been several attempts to collect outstanding amounts. Healthfirst has been contracted to collect claims for 1999 and 2000. At the end of the contract, depending on their success, they will be rehired to collect 1991- 1998. Also, one (1) employee was sent to the Dispute Resolution Program, sponsored by the federal Department of Health and Human Services (DHHS), to learn more about solving aged disputes. Further, DHHS, Office of Inspector General, will be performing audits in 49 of the 50 states, including Kentucky, to determine how to improve drug rebate procedures.

As of June 30, 2002, the accounts receivable balance for the Drug Rebate Program was \$44,573,000. The uncollected portion for FY 02 is \$5,674,000. Medicaid is potentially losing millions of dollars that could help offset budget deficits in the coming and present fiscal year.

The Medicaid Drug Rebate Program, created by the Omnibus Budget Reconciliation Act of 1990, states the following:

Except as provided under V(b), to make such rebate payments for each calendar quarter within 30 days after receiving from the State the Medicaid Utilization Information defined in this agreement. Although a specific amount of information has been defined in I(n) of this agreement, the Manufacturer is responsible for timely payment of the rebate within 30

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-CHS-12-36: The Division Of Program Integrity Has A Large Outstanding Balance Of Accounts Receivable For The Drug Rebate Program (Continued)**

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days of receiving, at a minimum, information on the number of units paid, by NDC number. In the event that in any quarter a discrepancy in Medicaid Utilization Information is discovered by the Manufacturer, which the Manufacturer and the State in good faith are unable to resolve, the Manufacturer will provide written notice of the discrepancy, by NDC number, to the State Medicaid Agency prior to the due date in II(b). If the Manufacturer in good faith believes the State Medicaid Agency's Medicaid Utilization Information is erroneous, the Manufacturer shall pay the State Medicaid Agency that portion of the rebate amount claimed which is not disputed within the required due date in II (b).

In addition, proper accounting procedures for accounts receivables require balances be monitored and immediate action taken for outstanding balances.

**Recommendation**

We believe the new director and his staff are improving efforts for monitoring accounts receivable and implementing new procedures in an attempt to correct years of oversight. We recommend the accounts receivable balance continue to be monitored and collection procedures continue to be pursued.

**Management's Response and Corrective Action Plan**

*The Department for Medicaid Services concurs with the recommendation and will continue to monitor as well as pursue accounts receivable collections. Additionally, DMS will strive to enhance current collection procedures.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-CHS13-37: The Division Of Program Integrity Does Not Track Interest Due On Outstanding Drug Rebate Accounts**

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State Agency: Cabinet for Health Services

Federal Program: CFDA 93.778 – Medical Assistance Program

Federal Agency: U.S. Department of Health and Human Services

Pass-Through Entity: Not Applicable

Compliance Area: Allowable Costs/Cost Principles

Amount of Questioned Costs: None

The Division of Program Integrity (Program Integrity) does not track interest due on outstanding balances for the Drug Rebate Program. As part of our testing for collections, as required by the Compliance Supplement, we noted 47 of the 100 manufacturers tested had interest due. Forty manufacturers did not pay any interest. Of the seven (7) that paid, there was no evidence the agency verified the amount paid was reasonable. The auditors inquired how interest was computed on outstanding balances. The agency explained the manufacturers computed it. No one in the agency recomputed to determine the amount paid was appropriate. Program Integrity has the responsibility to track the amount of interest due from each manufacturer. The director and manager have been made aware of this problem and are trying to have the interest due calculated automatically, so a comparison can be made when payments are received.

The Medicaid Drug Rebate Program, created by the Omnibus Budget Reconciliation Act of 1990, states:

The balance due, if any, plus a reasonable rate of interest as set forth in section 1903(d)(5) of the Act, will be paid or credited by the Manufacturer or the State by the due date of the next quarterly payment in II(b) after resolution of the dispute.

Since Program Integrity is not tracking interest, the state could be losing several thousand dollars to offset the federal match. Drug manufacturers are responsible for calculating and paying the proper interest rates. However, this does not relieve Program Integrity of the responsibility of control over this area and to know which manufacturers should be paying interest and how much interest they should be receiving.

Government entities should maintain control over accounts receivables as stewards of public funds. Allowing companies to calculate and pay interest with no checks or oversight allows for discrepancies and is a lack of control.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-CHS13-37: The Division Of Program Integrity Does Not Track Interest Due On Outstanding Drug Rebate Accounts (Continued)**

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**Recommendation**

We recommend Program Integrity calculate and track interest due on outstanding balances so comparisons can be made to manufacturers payments and any discrepancies corrected.

**Management's Response and Corrective Action Plan**

*Program Integrity is currently working to redesign the system to calculate and track the interest on outstanding accounts, and we anticipate our system will be sufficiently programmed and tested for this function between July 1 and August 1, 2003.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-CHS14-38: The Division Of Managed Care Does Not Maintain Records Of Complaints And Grievances**

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State Agency: Cabinet for Health Services

Federal Program: CFDA 93.778 – Medical Assistance Program

Federal Agency: U.S. Department of Health and Human Services

Pass-Through Entity: Not Applicable

Compliance Area: Special Test and Provisions

Amount of Questioned Costs: None

For three (3) years, we have performed testing of internal controls and compliance of the Complaint/Grievance Call Log System. This system is intended to handle beneficiary complaints for receiving negligent or improper care and provider complaints for failure to receive payment for services. The system also helps ensure beneficiaries have adequate access to health care from managed care organizations. Each year, CHS has stated in its corrective action plan that a new system was being implemented. In response to the comment for FY 01, the Management and Corrective Action Plan stated the following:

*The Department for Medicaid Services is in the process of moving to a new technology by going to a client server environment that will be used to develop and implement the Health Insurance Portability and Accountability Act (HIPAA) requirements. The QCSI-based (QCSI is Quality Care Solutions, Inc., which is a health care software vendor. See <http://www.qcsi.com>) solution has features the current Medicaid Management Information System (MMIS) does not have (e.g., an integrated call tracking feature). Each call will be logged based on time of call, user ID (person entering information into the system) and will be linked to the provider number (if the provider is enrolled into the Medicaid program) and/or to the member's Medical Assistance Identification (MAID) number. If the caller is provider/member not enrolled in the Medicaid program the call will be logged by name.*

When the APA requested access to the complaint log, the auditors were told that the complaints were documented on paper forms. After the call was routed to the proper division, the form was not saved due to lack of storage space. Thus, we could not perform tests in this area.

The complaint/grievance system cannot be used to its full potential by agency personnel unless all data is entered into the system. For FY 02, there is no evidence the complaint/grievance system was even used. Therefore, Medicaid providers and recipients problems may go unresolved. Unresolved problems could lead to endangerment of Kentuckians or fraud not being examined.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-CHS14-38: The Division Of Managed Care Does Not Maintain Records Of Complaints And Grievances (Continued)**

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A government entity needs an internal control structure that provides a way to ensure compliance with laws and regulations. The complaint/grievance log is intended to ensure provider and recipient problems are examined.

**Recommendation**

We recommend the agency follow through with its corrective action plan from 2001. If this cannot be done then a complaint/grievance log system should be implemented that can be tracked and tested. This will ensure agency personnel have all relevant data to make determinations on how to resolve a complaint/grievance.

**Management's Response and Corrective Action Plan**

*The Department for Medicaid Services currently operates a toll-free number for Medicaid recipients to request assistance with problems and concerns they have regarding the Medicaid program. This is not a provider assistance line. Providers are assisted through a separate provider relations line with our fiscal agent. Medicaid does utilize a call tracking system that tracks the number of calls, how long it takes to answer a call, which Representative took the call, how long the call lasts, how many calls are lost and gives recipients the opportunity to leave a message if their call is not answered timely.*

*Beginning in January 2003, the Medicaid Member Services Branch implemented a temporary electronic tracking system using Excel Spreadsheets. Calls are logged as they come in. For each phone call, the Member Service Representative logs the caller's name and phone number, the recipient's name and Medicaid ID number, a description of the problem/issue, the resolution, and to whom the call was transferred. The spreadsheets are collected electronically at the end of each day and filed in electronic folders. This is a temporary system until Medicaid implements a new call tracking system on June 1, 2003. The new system will be capable of collecting the information mentioned above and will electronically link the recipient call to the Representatives and allow the Representatives and supervisors to electronically track cases until they are closed. The new system will also allow Representatives to access other information pertinent to the recipient.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-JUST1-39: The Justice Cabinet Should Develop An Indirect Cost Allocation Plan And Submit It To The Cognizant Federal Agency For Approval**

State Agency: Justice Cabinet – Office of the Secretary

Federal Program: CFDA 16.575 – Crime Victim Assistance

CFDA 16.579 – Byrne Formula Grant Program

CFDA 16.588 – Violence Against Women Formula Grants

Federal Agency: U.S. Department of Justice

Pass-Through Agency: Not Applicable

Compliance Area: Allowable Costs/Cost Principles

Amount of Questioned Costs: Not Applicable

Indirect costs are those costs that benefit common activities and, therefore, cannot be readily assigned to a specific direct cost objective or project. Although the Justice Cabinet, Office of the Secretary, Grants Management Branch (GMB) does not have an approved indirect cost allocation plan in place for charging indirect costs to federal grants, indirect costs are included as part of the administrative costs for the agency.

Charging indirect costs to federal grants without an approved indirect cost allocation plan in place is not in compliance with OMB Circular A-133, Compliance Supplement Part 3 - Compliance Requirements, Section B, Allowable Costs/Cost Principles.

OMB Circular A-133 Compliance Supplement Part 3, Section B, Allowable Costs/Cost Principles, states, “In order to recover indirect costs, organizations must prepare cost allocation plans (CAPs) which apply only to state, local and Indian tribal governments or indirect cost rate proposals (IDCRPs) in accordance with the guidelines provided in OMB’s Circulars.”

**Recommendation**

We recommend GMB develop an appropriate indirect cost plan and submit it to the cognizant federal agency for approval. According to Chapter 17 of the U.S. Department of Justice Financial Guide, “Copies of brochures of indirect cost rates that may describe the procedures involved in the computation may be obtained from the U.S. Superintendent of Documents, United States Government Printing Office, Mail Stop: SSOP, Washington, DC 20402-9328.” GMB should request a copy of ASMB C-10-A, *Guide for State, Local, and Indian Tribal Governments, Cost Principles and Procedures for Establishing Cost Allocation Plans and Indirect Cost Rates for Agreements with the Federal Government*.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-JUST1-39: The Justice Cabinet Should Develop An Indirect Cost Allocation Plan And Submit It To The Cognizant Federal Agency For Approval (Continued)**

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**Management's Response and Corrective Action Plan**

*The Justice Cabinet, Office of the Secretary, GMB is in agreement with the Findings and Recommendations concerning Indirect Costs. The following steps will be taken to bring the GMB into compliance.*

*As recommended, the Justice Cabinet, Office of the Secretary will obtain the necessary information to formulate an indirect cost plan. Once formulated, the plan will be submitted to our federal cognizant agency for approval. The GMB will provide assistance to the Division of Administration as needed. The Justice Cabinet, Office of the Secretary will notify the APA if any problems are encountered.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-JUST2-40: The Justice Cabinet Should Develop Written Subrecipient Monitoring Policies And Procedures To Ensure Subrecipient Monitoring Is Properly Performed And Documented**

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State Agency: Justice Cabinet – Office of the Secretary

Federal Program: CFDA 16.575 – Crime Victim Assistance

CFDA 16.579 – Byrne Formula Grant Program

CFDA 16.588 – Violence Against Women Formula Grants

Federal Agency: U.S. Department of Justice

Pass-Through Agency: Not Applicable

Compliance Area: Subrecipient Monitoring

Amount of Questioned Costs: Not Applicable

We reviewed GMB's policy and procedures manual and interviewed personnel to determine the extent that subrecipient monitoring activities were performed for the programs in this audit. We found there was no specific set of procedures performed consistently to monitor subrecipient activity.

There was no indication of a monitoring schedule or log to determine which subrecipients would receive desk, telephone, or site monitoring reviews. With no schedule available, and no written policy for monitoring activities, we could not determine if the agency complied with its own goals for subrecipient monitoring activities.

In the subrecipient files that we reviewed, there were several instances of missing quarterly reports. We were able to review the supporting documentation for the reports to verify that correct reimbursement payments were processed, but the original approved quarterly report was not located in several cases.

We also found insufficient documentation in the subrecipient files to determine what monitoring activities were performed or how often they were performed.

We only found a few completed monitoring tools in the subrecipient files. There was no documentation of when or if a desk review was conducted; therefore, we could not determine whether there was sufficient monitoring during the audit period.

Sufficient monitoring activities were not performed to ensure subrecipients were using federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements and that performance goals were achieved.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-JUST2-40: The Justice Cabinet Should Develop Written Subrecipient Monitoring Policies And Procedures To Ensure Subrecipient Monitoring Is Properly Performed And Documented (Continued)**

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According to OMB Circular A-133, Subpart D (d) Pass-through entity responsibilities,

A pass-through entity shall perform the following for the federal awards it makes: . . .

- (3) Monitor the activities of subrecipients as necessary to ensure that Federal awards are used for authorized purposes in compliance with laws, regulations, and the provisions of contracts or grant agreements and that performance goals are achieved.

**Recommendation**

We recommend GMB develop policies and procedures to ensure subrecipient monitoring activities are being performed consistently and on a regular basis. We further recommend that documentation of these activities be filed in the subrecipient files when performed.

**Management's Response and Corrective Action Plan**

*The Justice Cabinet, Office of the Secretary, GMB agrees with the Findings and Recommendations concerning Subrecipient Monitoring.*

*The policy and procedures manual has been updated to clarify procedures used for both desk and on-site monitoring. A program and financial monitoring report has been developed that is completed at each on-site monitoring visit. A copy of each report will be filed in the subrecipient file upon completion.*

*A spreadsheet has been created using Excel that includes all current year awards. Subrecipients that experience consistent problems during the desk monitoring and subrecipients that are not required to receive an annual audit will be given priority for on-site monitoring. The remaining programs will be selected randomly. As each on-site monitoring visit is scheduled the date of the scheduled audit is noted on the spreadsheet. Also, the dates the reports are completed and filed are noted on the spreadsheet.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
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(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-JUST2-40: The Justice Cabinet Should Develop Written Subrecipient Monitoring Policies And Procedures To Ensure Subrecipient Monitoring Is Properly Performed And Documented (Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

*Desk monitoring includes a review of the financial and program reports submitted by the subrecipient on a quarterly and/or monthly basis. Financial review includes reconciling the supporting documentation submitted with the financial report to the original approved budget. Minor deficiencies are addressed through either telephone or email contacts with the subrecipient and could include a request for additional information, mathematical correction on a financial report or the deletion of items not approved in the original budget. A signed copy of the quarterly and/or monthly financial report by the Auditor II indicates that the document has been reviewed/monitored and constitutes a desk monitoring of the subrecipient unless otherwise indicated on the financial report. Supporting documentation for financial reports is already required for the Byrne program. Beginning with the quarterly report for the period covering January 1, 2003 - March 31, 2003, supporting documentation will also be required for the VOCA [Crime Victim Assistance Grant] and VAWA [Violence Against Women Formula Grants] programs. Program reports are also reviewed/monitored on a quarterly basis. Any problems associated with the report are reconciled through telephone or email conversations with the subrecipient.*

**COMMONWEALTH OF KENTUCKY  
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FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-JUST3-41: The Justice Cabinet Should Perform Sufficient Subrecipient Monitoring Activities To Ensure Subrecipients Expending More Than \$300,000 In Federal Awards Receive OMB Circular A-133 Audits**

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State Agency: Justice Cabinet – Office of the Secretary

Federal Program: CFDA 16.575 – Crime Victim Assistance

CFDA 16.579 – Byrne Formula Grant Program

CFDA 16.588 – Violence Against Women Formula Grants

Federal Agency: U.S. Department of Justice

Pass-Through Agency: Not Applicable

Compliance Area: Subrecipient Monitoring

Amount of Questioned Costs: Not Applicable

GMB did not perform sufficient subrecipient monitoring activities to ensure subrecipients expending more than \$300,000 in federal awards received OMB Circular A-133 audits.

For those subrecipients that had audits on file at GMB, there was no documentation of a desk review performed on the audit or record of follow-up on audit findings.

GMB did not properly advise subrecipients of their requirements as recipients of federal funds regarding audit reports, as the audit requirement information sent to subrecipients in the application package is not current.

During testing, we noted:

- There were five (5) subrecipients that expended more than \$300,000 in federal funds that did not submit an audit to GMB.
- In several audits on file, the subrecipients had numerous audit findings in internal control and compliance areas that could affect program administration. In one (1) instance, there was a reportable finding that affected the Byrne Program directly.

According to OMB Circular A-133, Subpart D (d) Pass-through entity responsibilities:

A pass-through entity shall perform the following for the federal awards it makes: . . .

- (2) Advise subrecipients of requirements imposed on them by Federal laws, regulations, and the provisions of contracts or grant agreements as well as any supplemental requirement imposed by the pass-through entity.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-JUST3-41: The Justice Cabinet Should Perform Sufficient Subrecipient Monitoring Activities To Ensure Subrecipients Expending More Than \$300,000 In Federal Awards Receive OMB Circular A-133 Audits (Continued)**

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- (3) Monitor the activities of subrecipients as necessary to ensure that Federal awards are used for authorized purposes in compliance with laws, regulations, and the provisions of contracts or grant agreements and that performance goals are achieved.
- (4) Ensure that subrecipients expending \$300,000 or more in Federal awards during the subrecipient's fiscal year have met the audit requirements of this part for that fiscal year.
- (5) Issue a management decision on audit findings within six (6) months after receipt of the subrecipient's audit report and ensure that the subrecipient takes appropriate and timely corrective action.
- (6) Consider whether subrecipient audits necessitate adjustments of the pass-through entity's own records . . .

**Recommendation**

We recommend GMB:

- develop procedures to ensure subrecipients that expend more than \$300,000 in federal funds in a year receive an OMB Circular A-133 audit.
- review the audits and follow up on audit findings within six (6) months after receipt of the audit. The audit desk review and follow up of audit findings should be properly documented in the subrecipient's file.
- update the audit requirement information provided to subrecipients in the application package to reflect the current audit requirements as determined by OMB Circular A-133.

**Management's Response and Corrective Action Plan**

*The Justice Cabinet, Office of the Secretary, Grants Management Branch (GMB) is in agreement with the Findings and Recommendations concerning A-133 Audit Compliance. The Cabinet will take the following steps to correct this issue.*

*A database will be created (Excel) that contains all subgrantees that expend more than \$300,000 in federal funds during a 12-month period. The spreadsheet will include the organization title, the period covered for the most current audit*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
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**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-JUST3-41: The Justice Cabinet Should Perform Sufficient Subrecipient Monitoring Activities To Ensure Subrecipients Expending More Than \$300,000 In Federal Awards Receive OMB Circular A-133 Audits (Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

*received, the date the audit was received and type of audit. If necessary, the subrecipient will be notified that an A-133 audit must be completed. This notification will include the dates to be covered by the audit and the time frame allowed for submission to the Cabinet (GMB).*

*All applicants are required to submit a copy of their most recent audit with their application package. The Cabinet (GMB) will develop a checklist for review of each audit. The checklist will include, but not be limited to, the period the audit covers, if any material weaknesses were noted or audit findings, was a management letter part of the audit, was the management letter included with the audit and is additional information needed to complete the audit review.*

*The audit requirement information contained in the application package has been updated and reflects the current audit requirements as determined by OMB Circular A-133. This form has been inserted in the original application for all federal programs. Information reported on this form will be used to create the database for those subrecipients that expend more than \$300,000 during a 12-month period.*

*The above noted Corrective Action Plan will be effective with the start of our 2003 award cycle which begins in March, 2003 with the Byrne application cycle; June, 2003 with the VOCA application cycle and September, 2003 with the VAWA application cycle.*

**COMMONWEALTH OF KENTUCKY  
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**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-JUST4-42: The Justice Cabinet Should Prepare Quarterly Financial Status Reports That Are Supported By Adequate Documentation**

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State Agency: Justice Cabinet – Office of the Secretary

Federal Program: CFDA 16.575 – Crime Victim Assistance

CFDA 16.579 – Byrne Formula Grant Program

CFDA 16.588 – Violence Against Women Formula Grants

Federal Agency: U.S. Department of Justice

Pass-Through Agency: Not Applicable

Compliance Area: Reporting

Amount of Questioned Costs: Not Applicable

We tested nine (9) of the SF 269A Financial Status Reports submitted by the GMB to the U.S. Department of Justice to determine if they were supported by sufficient, accurate documentation.

On the nine (9) reports tested, we could not trace some of the amounts on the reports to the agency's supporting documentation. The supporting documentation, in this case, is an internal spreadsheet that tracks expenditures of the subrecipients' federal share and local match.

Since the SF 269A Financial Status Reports contain the actual expenditures and unliquidated obligations as incurred for both the reporting period and cumulative for the award period, it is important that the amounts on the report be supported in the agency's accounting records.

According to the U.S. Department of Justice Financial Guide, Chapter 11: Reporting Requirements, "Grantees are also required to maintain adequate documentation to provide an audit trail that substantiates the amounts reported on each SF 269A as submitted."

**Recommendation**

We recommend GMB continue to address this issue and try to improve the internally generated "Status Report" to accurately reflect the quarter's expenditures, as well as cumulative expenditures for the local governments' federal share and local match.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-JUST4-42: The Justice Cabinet Should Prepare Quarterly Financial Status Reports That Are Supported By Adequate Documentation (Continued)**

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**Management's Response and Corrective Action Plan**

*The Justice Cabinet, Office of the Secretary, GMB disagrees with the Findings and Recommendations concerning SF269A Financial Status Reports. Listed below are the reasons for the disagreement.*

*Supporting documentation for federal expenditures reported on the SF 269A are taken directly from the Justice\_022602: Database not the internal status report. Using the Management and Reporting Database, this database reports expenditures and revenues from the MARS statewide accounting system for all state agencies, units of local government and non-profit organizations receiving federal funds from the Cabinet. Each federal award is assigned a separate entity-wide code number and the creation of this database allows the GMB to create reports that, either by summary or detail, report expenditures and revenues based on the MARS entity-wide code number. This report can be pulled by fiscal year, through a specific year, by fiscal year and beginning fiscal month and ending fiscal month, and also a detail report for a specific project number.*

*The GMB also maintains internal reports (cash book and status reports) for each federal award received. These reports contain summary information on all subgrantees that includes federal revenue disbursed and expenditures (both federal and match) reported. Prior to the creation of MARS these internal reports were used exclusively to report all expenditures on the SF 269A report. However, with the creation of the MARS system it was determined (and a federal financial monitor agreed) that federal financial data reported on the SF269A reports should be pulled from the statewide accounting system (MARS).*

*Information contained on the internal reports (status reports) are posted directly from the quarterly and/or monthly reports submitted by the subrecipient. Since we award funds to state agencies, and any of their grant related expenditures are posted directly to the MARS system as expended, it is very possible that federal expenditures reported on the internal status report and federal expenditures reported in the MARS system would not agree until the grant is ready to close. Because of this it was determined that in order to show true expenditures we would use the MARS reports to complete the SF269A instead of the internal status report. Therefore, it would be unlikely that federal expenditures reported on the SF269A would reconcile with federal expenditures reported on the internal status report.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-JUST4-42: The Justice Cabinet Should Prepare Quarterly Financial Status Reports That Are Supported By Adequate Documentation (Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

*The internal status report is used to report match expenditures on the SF269A, therefore, match expenditures reported on the SF 269A should reconcile with the total match expenditures reported on the internal status report.*

**Auditor's Reply**

While we acknowledge that GMB has implemented procedures to accurately reflect part of the information reported on the SF 269A, a weakness still exists in the compilation of data, specifically for the matching expenditures, block/formula pass through, and the federal funds subgranted, for the remainder of the federal report. These amounts were not available on the Justice\_022602: Database report in MARS and can only be obtained from the internal status reports. Therefore, to strengthen the reporting process, GMB should improve the internally generated status report as set forth in the recommendations to assure accuracy of all amounts on the SF-269A Financial Status Report.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-MIL1-43: The Department Of Military Affairs Should Ensure Subrecipient Monitoring Is Properly Performed**

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State Agency: Department of Military Affairs

Federal Program: CFDA 83.544 – Public Assistance Grants

Federal Agency: U.S. Federal Emergency Management Agency

Pass-Through Agency: Not Applicable

Compliance Area: Subrecipient Monitoring

Amount of Questioned Costs: None

We tested the Department of Military Affairs' (DMA) system for monitoring subrecipient compliance with OMB Circular A-133 provisions and determined not all required entities have filed audit reports. We noted DMA does not have a system in place for tracking its subrecipients, who were required to have an audit, or following up on findings that related to the federal programs. By not receiving audit reports and tracking subrecipient compliance with audit requirements, DMA is not in compliance with OMB Circular A-133.

DMA cannot be assured that subrecipients are expending federal awards for their intended purpose and complying with the requirements of OMB Circular A-133 without having proper monitoring procedures in place.

OMB Circular A-133, Subpart B states: “[N]on-Federal entities that expend \$300,000 or more in a year in Federal awards shall have a single or program-specific audit conducted for that year in accordance with the provisions of this part.”

In addition, according to OMB Circular A-133, Subpart D(d) Pass-through entity responsibilities:

A pass-through entity shall perform the following for the Federal awards it makes: . . .

- (4) Ensure that subrecipients expending \$300,000 or more in Federal awards during the subrecipient's fiscal year have met audit requirements of this part for that fiscal year.
- (5) Issue a management decision on audit findings within six (6) months after receipt of the subrecipient's audit report and ensure that the subrecipient takes appropriate and timely corrective action.
- (6) Consider whether subrecipient audits necessitate adjustment of the pass-through entity's own records.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
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(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-MIL1-43: The Department Of Military Affairs Should Ensure Subrecipient Monitoring Is Properly Performed (Continued)**

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- (7) Require each subrecipient to permit the pass-through entity and auditors to have access to the records and financial statements as necessary for the pass-through entity to comply with this part.

DMA has the following responsibilities under OMB Circular A-133, Subpart D (d):

- 1) Advise subrecipients of requirements imposed on them by federal laws, regulations, and provisions of contracts or grant agreements as well as any supplemental requirements imposed by the pass-through entity;
- 2) Ensure required audits are performed and require subrecipients to take prompt corrective action on any audit findings; and,
- 3) Evaluate the impact of subrecipient activities on the pass-through entity.

**Recommendation**

A policies and procedures manual would make the subrecipient monitoring process more effective and easier to follow. It would also ensure compliance with OMB Circular A-133 subrecipient monitoring compliance requirements. In particular, OMB Circular A-133 requires the pass-through entity, DMA, to receive audit reports from subrecipients required to have an audit in accordance with OMB Circular A-133, issue “timely” management decisions on audit and monitoring findings, and requires subrecipients to take “timely” corrective action on deficiencies identified in audits and subrecipient monitoring. OMB Circular A-133 does not specify what “timely” means; however, a DMA subrecipient monitoring policies and procedures manual could define that to ensure compliance and consistency.

The written policies and procedures should contain, at a minimum, the following:

- 1) Communication of federal award requirements to the subrecipients.
- 2) The responsibilities for monitoring and tracking subrecipients in a timely manner, with a definition of what “timely” means. An example would be to have deadlines for the response on each correspondence sent to the subrecipient and/or independent auditor, and after a maximum number of sent correspondences (such as three (3)), the file would be forwarded to General Counsel for pursuit of noncompliance items.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-MIL1-43: The Department Of Military Affairs Should Ensure Subrecipient Monitoring Is Properly Performed (Continued)**

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**Recommendation (Continued)**

- 3) Specific monitoring processes.
- 4) Methodology for resolving the findings of subrecipient noncompliance or weaknesses in internal control and a timeline for corrective action.
- 5) Requirements for processing subrecipient audits, including appropriate adjustment of pass-through entity's accounts, such as through the sanctions mentioned above.
- 6) Impose sanctions, disallow overhead costs, disallow expenditures, suspend federal awards, or terminate the federal award for subrecipients who fail to meet the audit requirements as set forth by the OMB Circular A-133.
- 7) Deny all requests for extensions made by the subrecipient who is failing to meet said requirement.
- 8) Establish a time limit on extensions for submitting an audit.

**Management's Response and Corrective Action Plan**

*After a review of the findings we feel that there is only one area we are lacking in relative to tracking and responding to audits where a local government has received \$300,000 or more federal dollars in a state fiscal year, and are unsure where this responsibility lies.*

*OMB-133 defines, in sub-part D, the following responsibilities for the Pass-through entity (DMA, KyEM):*

1. *"Identify Federal awards made by informing each subrecipient of CFDA title and number, award name and number, award year, if the award is R&D, and name of the Federal agency."*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
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(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-MIL1-43: The Department Of Military Affairs Should Ensure Subrecipient Monitoring Is Properly Performed (Continued)**

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**Management’s Response and Corrective Action Plan (Continued)**

*All Projects written by FEMA [Federal Emergency Management Agency] are identified by a unique number assigned to the project and are further identified by the FEMA disaster number (i.e. FEMA 1414-DR). This unique number tracks projects through completion. There is a very well defined Local/State agreement signed by the State and the Applicants Agent at the beginning of the project that outlines the recipients responsibilities for reporting and the audit requirements contained in OMB-133.*

*All large projects (\$52,000 and above) are paid only on the receipt of actual cost and the documentation is reviewed to ensure the funds requested are in fact accurate and are allowable costs toward the project. In addition, all large projects require a final inspection by FEMA and State staff to ensure the project is completed as indicated by the recipient and in accordance with federal guidelines.*

*2. “Advise subrecipients of requirements imposed on them by Federal laws, regulations, and the provisions of contract or grant agreements as well as any supplemental requirements imposed by the pass-through entity.”*

*All recipients that receive Federal funds as a result of a Presidential Declaration are required to attend a briefing (4 hours) that fully explains the State/FEMA process and documentation requirements in order to receive the funds. Additionally, these requirements are set forth in the Local/State agreement.*

*3. “Monitor the activities of subrecipients as necessary to ensure that Federal awards are used for authorized purposes in compliance with laws, regulations, and the provisions of contracts or grant agreements and that performance goals are achieved.”*

*All project information is reviewed by the FEMA and our Public Assistance Unit and is filed as a part of the applicants record. Every request for State/Federal funds is reviewed to ensure that the correct documentation is submitted to support the request.*

*4. “Ensure that subrecipients expending \$300,000 or more in Federal awards during the subrecipient’s fiscal year have met the audit requirements of this part for that fiscal year.”*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-MIL1-43: The Department Of Military Affairs Should Ensure Subrecipient Monitoring Is Properly Performed (Continued)**

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**Management’s Response and Corrective Action Plan (Continued)**

*We are unsure if this is a program specific issue or does this include ALL federal funds received? If this is inclusive of all federal funds how do we determine the total amount of funds received and which agency is responsible for reviewing the audit?*

5. *“Issue a management decision on audit findings within six months after receipt of the subrecipient’s audit report and ensure that the subrecipient takes appropriate and timely corrective action.”*

*This specific requirement is not clearly defined as to who is responsible to monitor. Again, is this inclusive of all funds received or specific to the FEMA/State agreement for that disaster. If we are required to complete this process we will need to look at the workload of the division and determine what functions will have to be eliminated to ensure this requirement is completed. Our staff has been reduced by 6 positions this budget year and will likely not be filled in the near future.*

6. *“Consider whether subrecipient audits necessitate adjustment of the pass-through entity’s own records.”*

*All transactions from the beginning to end of a project are tracked internally as well as in the FEMA database called NEMIS. This allows the federal government to view all projects as well as our staff. Our procedures will not change until FEMA implements a new program to monitor projects.*

7. *“Require each subrecipient to permit the pass-through entity and auditors to have access to the records and financial statements as necessary for the pass-through entity to comply with this part.”*

*This has never been an issue. We pay the subrecipient, for large projects, based on the actual receipts submitted to us for payment. This ensures we are provided all necessary documents.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-MIL1-43: The Department Of Military Affairs Should Ensure Subrecipient Monitoring Is Properly Performed (Continued)**

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**Auditor's Reply**

DMA, under OMB Circular A-133, Subpart D, should ensure that all federal grant recipients expending \$300,000 or more in grant money have an OMB Circular A-133 audit performed for the fiscal year in which the awards were spent. This would be for entities expending \$300,000 or more a year in federal awards. The subrecipient has nine (9) months from the end of the fiscal year to submit an audit. After the audit is conducted, DMA needs to make certain they obtain a copy of the audit, review the audit, and see if any findings pertaining to the grant were discovered. If findings were issued in the audit report, DMA should issue a management decision on the findings of the audit report within six (6) months after the receipt of the subrecipient's audit report. After the decision has been rendered, DMA should follow up on the findings to ensure the subrecipient corrected the findings in a timely manner.

DMA should devise a monitoring system for tracking subrecipients who are required under OMB Circular A-133 to have an audit performed. This monitoring system should be implemented for all federal programs with audit requirements.

While it appears DMA understands its responsibility and believes they comply with the subrecipient requirements, we were not presented with evidence indicating subrecipient activities met compliance requirements. The focus of our comment is to suggest DMA create a system to track, monitor, and follow through with subrecipient monitoring requirements.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-CPE1-44: The Council On Postsecondary Education Should Implement Additional Procedures To Ensure Required Information For Eisenhower Professional Development State Grants Is Obtained And Reviewed In A Timely Manner**

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State Agency: Council on Postsecondary Education

Federal Program: CFDA 84.281 – Eisenhower Professional Development State Grants

Federal Agency: U.S. Department of Education

Pass-Through Agency: Not Applicable

Compliance Area: Subrecipient Monitoring

Amount of Questioned Costs: None

Per review of the client-maintained “Final Program Report Status” listing, six of the fourteen Year 16 final reports due July 31, 2002 were not received in a timely manner.

Per review of the client-maintained “Interim Program Report Status” listing, nine of the sixteen Year 17 interim reports due July 31, 2002 were not received in a timely manner.

Per review of the client maintained “Audit Review Master Checklist” listing, the June 30, 2001 audited financial statements for four (4) of the 12 audit reports related to Year 15 and 16 projects had not been received by the January 31, 2002 deadline as indicated within the project year timelines located on the Council’s website. The Year 15 and 16 audited financial statements indicated as not being obtained prior to the January 31, 2002 deadline were subsequently received.

The Council is not able to perform subrecipient monitoring on a timely basis. Failure to receive such required information in a timely manner may prevent the Council from becoming aware of any potential problems.

The procedures in place did not ensure the receipt and/or review of such information in a timely manner.

**Recommendation**

The Council should implement additional procedures to ensure that the required information is obtained and reviewed in a timely manner.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-CPE1-44: The Council On Postsecondary Education Should Implement Additional Procedures To Ensure Required Information For Eisenhower Professional Development State Grants Is Obtained And Reviewed In A Timely Manner (Continued)**

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**Management's Response and Corrective Action Plan**

*Last year, the council staff established a tickler system for both program reports and audits. The tickler system for program reports includes: informing subrecipients of report deadlines in the RFP [Request for Proposal] timelines, through an annual written notice, stating the deadline in the MOA, and informing them in person during summer site visits. After the deadlines are reached, subrecipients are reminded by e-mail within 30 days of the deadline that the report is overdue.*

*Council staff is required to submit a report to the Kentucky Department of Education by December 31, reporting the status of Eisenhower programs and grants. In order to complete its report, council staff reviews the final reports from the subrecipients. All year 16 final program reports due July 31, 2001, were reviewed by December 2001.*

*The tickler system for the audits includes: posting the deadline requirement on the CPE website, and informing subrecipients of the deadline in a December letter prior to the January deadline. After the audit deadline is reached, subrecipients are reminded by e-mail within one week of the deadline that the report is overdue. In addition, phone calls are made to subrecipients as necessary. Council staff reviewed all subrecipient audits within two weeks of receiving the audits.*

*The council staff agrees that four audit reports were not received in a timely fashion. The Council staff believes that institutions have legitimate reasons for noncompliance. The four external audits were not complete by January 31, 2002 but were advanced as soon as the university's external auditors completed their work. The council staff did contact each institution where a report was delayed to determine the reason for the delay. It is the policy of the council to withhold reimbursement payments until reports are received.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-CPE2-45: The Council On Postsecondary Education Should Implement Additional Procedures To Ensure Required Information For Gaining Early Awareness And Readiness For Undergraduate Programs Is Obtained In A Timely Manner**

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State Agency: Council on Postsecondary Education

Federal Program: CFDA 84.334 – Gaining Early Awareness and Readiness for Undergraduate Programs

Federal Agency: U.S. Department of Education

Pass-Through Agency: Not Applicable

Compliance Area: Subrecipient Monitoring

Amount of Questioned Costs: None

The Council's "Memorandum of Agreement" required that subgrantees submit quarterly reimbursement request forms no later than the 15<sup>th</sup> day of the month subsequent to the end of the quarter. Per review of such documentation, it was noted that certain quarterly reimbursement request forms were submitted up to 90 days subsequent to the 15<sup>th</sup> day of the month after the end of the quarter.

The Council is not able to perform subrecipient monitoring on a timely basis.

The procedures in place did not ensure the receipt of such information in a timely manner.

**Recommendation**

The Council should implement additional procedures to ensure that the required information is obtained in a timely manner.

**Management's Response and Corrective Action Plan**

*The council staff agrees some reports were delinquent.*

*The MOA requires that a report be submitted by the stated deadline. It is the Council's practice to have the subgrantee first submit an electronic draft to Council staff for review prior to obtaining the authorizing signatures needed for disbursement. No disbursements are made without a signed report. The council staff implemented a log to identify the dates when all reimbursement reports are received, extensions are granted (if applicable), and payments are approved.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-CPE2-45: The Council On Postsecondary Education Should Implement Additional Procedures To Ensure Required Information For Gaining Early Awareness And Readiness For Undergraduate Programs Is Obtained In A Timely Manner (Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

*Council staff sends all subgrantees e-mail reminders prior to upcoming deadlines and immediately follows up with subgrantee when deadlines are not met. The Council will continue working with all subgrantees to ensure required reports are submitted accurately and timely.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-TC2-46: The Transportation Cabinet Should Develop Internal Controls To Ensure Accurate Presentation Of The Annual Federal Highway Administration Statistics Report**

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State Agency: Transportation Cabinet

Federal Program: CFDA 20.205 – Highway Planning and Construction

Federal Agency: U.S. Department of Transportation

Pass-Through Agency: Not Applicable

Compliance Area: Reporting

Amount of Questioned Costs: None

At the end of each federal fiscal year, the local FHWA office sends an e-mail to the Division of Right of Way and Utilities requesting the Annual FHWA Statistics Report. When inquiring of Transportation Cabinet management about the internal control procedures in place for the preparation of the report, we noted the following:

- There was no immediate supervisory review of the report performed for FY 02.
- There were no procedures in place to identify unreliable source data for the report in FY 02.
- There were no periodic comparisons of the report to supporting records in FY 02; however, with the implementation of newly established reporting codes in the Relocation Area, the Division of Right of Way and Utilities is in the process of developing a report that will be compared to the data in MARS on a quarterly basis starting in FY 03. This new process involves both acquisitions and relocation.

Without supervisory review, procedures to verify underlying source data, and periodic comparison to supporting records, the data and information reported to FHWA may be inaccurate and incomplete.

Part 6-L of the March 2002 Compliance Supplement to OMB Circular A-133 lists the following under Control Objectives for reporting:

To provide reasonable assurance that reports of Federal awards submitted to the Federal awarding agency or pass-through entity include all activity of the reporting period, are supported by underlying accounting or performance records, and are fairly presented in accordance with program requirements.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-TC2-46: The Transportation Cabinet Should Develop Internal Controls To Ensure Accurate Presentation Of The Annual Federal Highway Administration Statistics Report (Continued)**

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Part 6-L lists the following controls under Risk Management, Control Activities, and Monitoring to help achieve the control objectives:

- Risk Management, “Identification of underlying source data or analysis for performance or special reporting that may not be reliable.”
- Control Activities, “Supervisory review of reports performed to assure accuracy and completeness of data and information included in the reports.”
- Monitoring “Periodic comparison of reports to supporting records.”

The report described in the CFR quote below is compiled from the Annual FHWA Statistics Reports prepared by the Transportation Cabinet and submitted to FHWA. Every three (3) years, the annual reports are consolidated by FHWA and sent to Congress to fulfill the requirements of 49 CFR 24.9 (c).

49 CFR 24.9 (c) states,

The agency shall submit a report of its real property acquisition and displacement activities under this part if required by the Federal agency funding the project. A report will not be required more frequently than every 3 years, or as the Uniform Act provides, unless the Federal funding agency shows good cause. The report shall be prepared and submitted in the format contained in Appendix B of this part.

**Recommendation**

We recommend the Division of Right of Way and Utilities:

- Develop procedures to perform a supervisory review of the Annual FHWA Statistics Report.
- Complete the process of developing a report that will be compared to the data in MARS on a quarterly basis and perform those comparisons as planned.
- Document both variances found during the comparisons above and the resolution of those variances.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-TC2-46: The Transportation Cabinet Should Develop Internal Controls To Ensure Accurate Presentation Of The Annual Federal Highway Administration Statistics Report (Continued)**

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**Management's Response and Corrective Action Plan**

*The Division of Right Of Way/Utilities acknowledges the Control Weakness outlined in this report. As noted in the paragraph titled "Nature of the Weakness," steps to correct the weakness began January 1, 2003.*

*The Federal Statistical Report has been a difficult report to complete for years. The division, for years, maintained multiple ledgers of expenditures and those recordings were used to prepare the Federal Report. With the employment of automation and the data being maintained in the Division of Accounts, the division discontinued the keeping of its ledgers and began to rely on information furnished by Accounts. With the audit of the 2001 Records, it was learned that the data furnished for the federal report is not consistent with previous reports and, in fact, the information furnished has not been accurate or representative of the correct expenditures. The difficulty of the process has been compounded with changes to the Report Form and a lack of clear instructions for completion.*

*Beginning January 1, 2003 the Division again began a ledger of expenditures. The data will be used to confirm and compare with data from Accounts. Further, to better ensure accuracy, quarterly comparisons will be made of data from the two sources of information and the findings will be reviewed by the Branch Manager of Acquisition and the Branch Manager of Relocation Assistance. Differences will be reconciled prior to the preparation of the Annual Report.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-TC3-47: The Transportation Cabinet Should Ensure The Annual Federal Highway Administration Report Is Compiled In Compliance With Federal Guidelines**

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State Agency: Transportation Cabinet

Federal Program: CFDA 20.205 – Highway Planning and Construction

Federal Agency: U.S. Department of Transportation

Pass-Through Agency: Not Applicable

Compliance Area: Reporting

Amount of Questioned Costs: None

During our testing of the Consolidated Annual Statistical Report submitted to FHWA, we noted that, although the accuracy of the report is improving, the following problems occurred:

- Acquisition expenditure data was extracted from MARS for federal FY 01 when FY 02 is the reporting period.
- The statistical report is not consistent in presentation of acquisition and relocation expenditures. Relocation expenditure amounts include the state match for the federal funds expended while acquisition expenditure amounts do not.
- Last Resort Housing payments were not subtracted from Replacement Housing Payments (RHP) for the report.

The noncompliances listed above caused the following misstatements, respectively:

- The amount reported for acquisitions conducted by the State Highway Agency was overstated by \$1,898,153, and the amount reported for acquisitions conducted by local public agencies was understated by \$808,817.
- Amounts reported for relocation activities were overstated by \$341,552 in total.
- Last Resort Housing payments of \$39,220 were double-counted, which contributed to the overstatement in relocation activities previously mentioned above. Specifically, Down Payments and RHP for Owners were overstated in the report due to the double-counting of Last Resort payments.

The reporting period should be October 1, 2001 to September 30, 2002, as indicated at the top of the statistical report form.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-TC3-47: The Transportation Cabinet Should Ensure The Annual Federal Highway Administration Report Is Compiled In Compliance With Federal Guidelines (Continued)**

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Per conversation with FHWA, the Transportation Cabinet may either include or exclude the state's matching funds in the statistical report. FHWA prefers the Transportation Cabinet include the state match. Either way, treatment should be consistent for both acquisition and relocation expenditure amounts reported.

The instructions for the Consolidated Statistical Reporting Form state, "Last Resort payment figures should only report the number of cases where payments exceeded the maximum supplement, and the dollar amount of that excess. The maximum supplement amount should be reflected on lines for either the Rental Supplement, Down Payments, or RHP for Owners."

**Recommendation**

We recommend the Division of Right of Way and Utilities send an amended report or send corrections for the previous report to FHWA. We also recommend for future reports that the Division of Right of Way and Utilities:

- Ensure that data is extracted from MARS for the correct reporting period;
- Be consistent with how acquisition and relocation expenditures are reported in regard to whether state matching funds are reported; and,
- Ensure that relocation figures are reported as required by the instructions that accompany the report.

**Management's Response and Corrective Action Plan**

*The Division of Right of Way /Utilities acknowledges the noncompliance as outlined in the report. As noted in our response to "Control of Weakness 02-TC-2", the preparation of the Federal Statistical Report has been difficult to complete since we began to rely upon electronic records kept by the Division of Account. Prior to the time we began to depend on the data from that office, the division maintained handwritten ledgers of all expenditures from which we abstracted numbers each year for the report. With automation, we were encouraged to dispense with the "double accounting" and began to get the numbers from Accounts.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-TC3-47: The Transportation Cabinet Should Ensure The Annual Federal Highway Administration Report Is Compiled In Compliance With Federal Guidelines (Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

*Problems were encountered from the beginning with the new process. First, the Federal Statistical Report does not include all expenditures but only those directly related to compensation paid for properties and relocation assistance payments. Relocation payments had to be broken down further into the various types of const, i.e., residential, business, non-profit, etc. Since the Division of Accounts' records did not differentiate between those type payments, we continue to maintain ledgers for relocation payments. Those payments represent the total amounts paid for each category. Conversely, the payment amounts provided by the Division of Accounts only represent the amount actually billed to the Federal Highway Administration, or approximately 80% of the total cost to acquire.*

*In mid 2002, as an effort to simplify the development of the Federal Report, additional codes were established with the Division of Accounts. When we began to prepare the Federal Statistical Report for 2002, in addition to not getting the numbers for the correct Fiscal Year after repeated efforts, it was still difficult to extract from all the numbers provided exactly the ones to be included. For that reason, beginning January 1, 2003, the division has begun again the keeping of ledgers of all payments made for acquisitions and condemnations. The ledgers represent the actual dollars spent rather than only the amount actually billed to FHWA. The ledgers and numbers from the Division of Accounts will be reviewed and tabulated at the end of each quarter and reviewed by the Branch Managers of Acquisition and Relocation Assistance.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-TC4-48: The Transportation Cabinet Should Ensure Federal Expenditures Are Made Only For Allowable Costs**

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State Agency: Transportation Cabinet

Federal Program: CFDA 20.205 – Highway Planning and Construction

Federal Agency: U.S. Department of Transportation

Pass-Through Agency: Not Applicable

Compliance Area: Activities Allowed/Unallowed and Allowable Costs/Cost Principles

Amount of Questioned Costs: \$1,565

During our testing, we examined expenditures within the Utility Branch to determine if they were made for allowable costs as required by the Activities Allowed or Unallowed federal compliance requirement. We tested 14 subprojects and noted one (1) instance where a reimbursement was made for an unallowable cost. When this one (1) unallowable cost is projected to the entire population, the likely questioned costs are greater than \$10,000 and required to be a finding by OMB Circular A-133. However, this amount is not material to the compliance requirement being tested for this program.

In this situation, an Estimated Cost Sheet attached to the Lump Sum Project Agreement contained an allowance for a contingency of 10 percent of the total estimated costs. The entire amount of the estimated costs (including the contingency) was reimbursed in full with one lump sum payment by the Utilities Branch.

If adequate supervisory review of payments is not conducted, then the unallowable cost could remain undetected, resulting in the FHWA reimbursing an unallowable cost. In turn, if federal dollars are spent on unallowable costs, then this could result in the Transportation Cabinet spending its entire federal allotment and being unable to obtain federal funding for the other actual allowable costs.

OMB Circular A-133 section 510, Audit findings, paragraph (a) (3) states:

(a) Audit findings reported. The auditor shall report the following as audit findings in a schedule of findings and questioned costs: . . . (3) [k]nown questioned costs which are greater than \$10,000 for a type of compliance requirement for a major program. Known questioned costs are those specifically identified by the auditor. In evaluating the effect of questioned costs on the opinion on compliance, the auditor considers the best estimate of total costs questioned (likely questioned costs), not just the questioned costs specifically identified (known questioned costs). The auditor shall also report known questioned costs when likely questioned costs are greater than \$10,000 . . .

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-TC4-48: The Transportation Cabinet Should Ensure Federal Expenditures Are Made Only For Allowable Costs (Continued)**

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In addition, part 12 of Attachment B of OMB Circular No. A-87, *Selected Items of Cost* states, “Contributions to a contingency reserve or any similar provision made for events the occurrence of which cannot be foretold with certainty as to time, or intensity, or with an assurance of their happening are unallowable.”

**Recommendation**

We recommend the Division of Right of Way and Utilities take the following actions:

- Remind staff that expenditures should only be made for allowable costs.
- Provide additional training to staff members to help them identify and distinguish the difference between allowable and unallowable costs.
- Conduct a more thorough review of expenditures at the supervisory level to ensure reimbursements are made only for allowable costs.

**Management’s Response and Corrective Action Plan**

*The Division concurs with the Notice of Non-Compliance.*

*The Utilities Branch had the misfortune of losing some experienced district personnel and all Central Office Area Coordinators in 2000 and 2001. The replacement personnel are rapidly developing and becoming more skilled, but they still lack the experience and expertise of those retired. Central Office Management has made a greater effort to review agreements to best ensure certain key information contained therein is accurate, but estimates have not been reviewed as carefully due to limited time and personnel.*

*Corrective action relative to this issue has begun. District Utility Agents are being reminded that miscellaneous and contingency charges are not allowable in Lump Sum Agreements. Further, instructions and procedures relative to this issue will be outlined in the revised policy and procedures guide that is being developed for Utilities. In the future, lump sum estimates are to be reviewed more carefully by Central Office to best ensure those type costs are not included in the estimate.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-TC4-48: The Transportation Cabinet Should Ensure Federal Expenditures Are Made Only For Allowable Costs (Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

*Our Division of Right of Way and Utilities is requesting a reimbursement from the vendor of the \$1,565. When the reimbursement is received we will credit the FHWA for the billed portion of the overpayment.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-TC5-49: The Transportation Cabinet Should Obtain Federal Highway Administration Approvals Prior To Granting Authority To Advertise And Before Actually Advertising For Projects**

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State Agency: Transportation Cabinet

Federal Program: CFDA 20.205 – Highway Planning and Construction

Federal Agency: U.S. Department of Transportation

Pass-Through Agency: Not Applicable

Compliance Area: Special Tests and Provisions

Amount of Questioned Costs: Not Applicable

The Transportation Cabinet did not obtain proper FHWA approval prior to granting authority to advertise or when advertising construction projects.

During our testing of construction expenditures, we noted four (4) of 25 projects tested did not obtain approval prior to granting the authority to advertise. Thus, construction projects were advertised prior to FHWA approval.

Per the 20.205 CFDA, “[t]he FHWA approval constitutes a commitment to pay the Federal share of the project cost.” In proceeding without this approval, projects not meeting federal guidelines may have to be the financial responsibility of the Commonwealth.

Part 4 of the OMB Circular A-133 Compliance Supplement for CFDA 20.205 states:

Construction projects administered under standard procedures cannot be advertised nor force account work commenced until FHWA: (1) approves the plans, specifications, and estimates; and (2) authorizes the State DOT to advertise for bids or approves the force account work (23 CFR sections 630.205(c), 635.211(a), and 635.309). Construction cannot begin until after FHWA concurs in the contract award (23 CFR section 635.114). This requirement does not apply to construction projects administered by the State DOT under 23 USC 106(c) which allow the State DOT to assume the responsibilities for design, plans, specifications, estimates, contract awards, and inspection of progress (23 USC 106 (c)).

**Recommendation**

We recommend the Transportation Cabinet obtain proper FHWA approvals prior to granting the authority to advertise and before the advertisement date for the projects.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-TC5-49: The Transportation Cabinet Should Obtain Federal Highway Administration Approvals Prior To Granting Authority To Advertise And Before Actually Advertising For Projects (Continued)**

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**Management's Response and Corrective Action Plan**

*We agree with the findings in the record of noncompliance. Realizing that many of the Transportation Cabinet projects have time restraints pertaining to weather and the construction season which created situations where we need to advertise, let, and award in a timely fashion. These types of projects are the exception.*

*We have changed our process to better insure that we have the available time to get the properly signed documents. We have project letting review meetings at least two weeks before the advertisement date to insure everything is in proper order. The FHWA is invited and typically attends. If we do not have the necessary approvals, we use those two weeks to obtain them. If we do not receive the required approvals, we will delay the advertisement of the project.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-CWD11-50: The Department For Training And ReEmployment Did Not Reconcile Subrecipient Expenditures To MARS**

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State Agency: Cabinet For Workforce Development

Federal Program: CFDA 17.255 – Workforce Investment Act

Federal Agency: U.S. Department of Labor

Pass-Through Agency: Not Applicable

Compliance Area: Reporting

Amount of Questioned Costs: None

Financial Status Reports (FSR) for Local Administration, Local Adult, Local Dislocated Worker, Local Youth, Rapid Response, and Local Statewide Activities expenditures do not reconcile to MARS. The Department for Training and ReEmployment (DTR) uses expenditure reports prepared by the Local Workforce Investment Areas (LWIA) to report local expenditures on the FSR. The expenditure data recorded in MARS only reflects the amounts reimbursed to LWIAs and has not been updated to reflect actual expenditures in the appropriate categories.

DTR has implemented its corrective action procedures to identify local expenditures for the three (3) funding streams: Adult, Dislocated Worker, and Youth Activities. DTR is currently making adjustments to open grants to accurately reflect expenditures in the correct grant/project number in MARS. However, the corrective action procedures do not allow for drawdown requests to distinguish between Local Administration, Local Rapid Response, and Local Statewide Activities from the three (3) local expenditure categories.

Reports submitted to the U.S. Department of Labor (USDOL) are not supported by the Commonwealth's official accounting system-MARS. LWIA expenditures have not been updated in MARS to accurately reflect expenditures by the subrecipients.

Proper internal controls dictate agencies maintain adequate supporting documentation for reports submitted to the federal government. MARS is the official record of expenditures. Further, DTR procedures indicate that this update of MARS should occur at least quarterly.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-CWD11-50: The Department For Training And ReEmployment Did Not Reconcile Subrecipient Expenditures To MARS (Continued)**

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**Recommendation**

We recommend DTR implement procedures to distinguish Local Administration, Local Rapid Response, and Local Statewide expenditures from the Local Adult, Dislocated Worker, and Youth Activities. DTR should fully use the capabilities of MARS to track grant expenditures, so that the Commonwealth's accounting system fully supports expenditures as submitted in federal reports. Additional activity codes or subprojects could be established to track these expenditures within the three (3) funding streams, and DTR should implement new drawdown requests to allow LWIAs to request funds from the appropriate category. Journal vouchers could be used to correct expenditures for Local Administration on a quarterly basis when the amounts are known.

**Management's Response and Corrective Action Plan**

*DTR will implement a policy to update the MARS system quarterly to reflect LWIA reported expenditures as Statewide 15%, Rapid Response, Local Administration, Local Adult Program, Local Youth Program, and Local Dislocated Worker Program. We disagree with the suggestion to revise the drawdown request because it would be counterproductive to revise the drawdown process to have the LWIAs access their funds according to budget line item rather than by project. The process of entering the expenditures would be excessively demanding for the staff involved and the local area staff would be unable to accurately classify their expenditures in advance of the funding request. If expenditures were to be reclassified the amounts would have to be refunded through a check and the funds accessed through electronic fund transfer under another category. We do not have the capability to receive funds electronically as credits.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-CWD12-51: The Department For Training And ReEmployment Should Implement Additional Procedures To Ensure Subrecipient Findings Are Followed Up On In A Timely Manner**

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State Agency: Cabinet For Workforce Development

Federal Program: CFDA 17.255 – Workforce Investment Act

Federal Agency: U.S. Department of Labor

Pass-Through Agency: Not Applicable

Compliance Area: Subrecipient Monitoring

Amount of Questioned Costs: None

During the FY 02 audit, we tested the audit log maintained by DTR to track subrecipient monitoring related to the required audits of subrecipients. During this review, we noted the following:

- DTR did not obtain and resolve the subrecipient audit reports in a timely manner.
- DTR does not have any way of determining when LWIAs receive the audit reports to ensure they comply with federal regulations on submitting them timely.
- Agency records were not reconciled to the subrecipients' audited financial statements. The reconciliation process was started; however, the differences had not been resolved.

DTR has implemented its corrective action plan as stated in the prior year response to the same finding. DTR has reassigned the responsibilities of monitoring subrecipient audit reports to the Program Compliance and Support Branch. The Financial and Program Operations Branch provided technical assistance in performing the reviews and reconciliations; however, this training was not complete until June 2002.

The effects of the weaknesses noted above include:

- The receipt of the audit reports in an untimely manner delays the entire resolution process. It also increases the likelihood that subrecipient weaknesses noted in the audit continue for a longer period of time since they are not being addressed.
- When agency records are not reconciled to audited financial statements, amounts used for federal reporting may be erroneous.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-CWD12-51: The Department For Training And ReEmployment Should Implement Additional Procedures To Ensure Subrecipient Findings Are Followed Up On In A Timely Manner (Continued)**

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According to OMB Circular A-133, the funding agency should be sent a copy of the audit report within the *earlier* of 30 days after [the subrecipient's] receipt of the auditor's report(s), or 9 months after the end of the audit period. This requirement is also outlined in DTR's Audit Resolution Guide and is in effect for fiscal years beginning after June 30, 1998. [OMB Circular A-133 Part 4 Subpart B, Sec 235 (c) (1).]

The Workforce Investment Act (WIA) regulations state, "The Governor is responsible for resolving findings that arise from the State's monitoring reviews, investigations and audits (including OMB Circular A-133 audits) of subrecipients." [20 CFR 667.500 (a) (1) and (2).]

Further, according to OMB Circular A-133, pass-through entities are responsible for issuing a management decision on audit findings of subrecipients within six months after receipt of the audit finding. [OMB Circular A-133; Subpart D Sec 400 (d) (5)] If corrective action has not been completed at that time, a timetable for follow-up may be included. [OMB Circular A-133; Subpart D Sec 405 (a)]

**Recommendation**

We recommend CWD and DTR implement procedures to ensure compliance with WIA regulations, OMB Circular A-133, and DTR guidelines regarding audit resolutions of subrecipients. We also recommend DTR obtain documentation regarding the date on which the subrecipients received the audit reports to ensure DTR receives the audit in accordance with OMB Circular A-133 requirements.

**Management's Response and Corrective Action Plan**

*Eighty (80) percent of the audit reports have been received and acted upon as of March 4, 2003. Reconciliations have been requested of LWIAs as required. Final determinations have been issued to 50% of LWIAs which have submitted audits. The remaining two LWIAs which have not submitted audits are expected to do so by March 30, 2003, nine months after the end of the audit period. To ensure that the LWIAs meet the submission requirements of OMB Circular A-133 [Subpart B, Sec 235 (c) (1).], DTR will send the LWIAs a reminder letter in August of each fiscal year to reiterate the submission requirements for the previous year's audit reports.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-CWD12-51: The Department For Training And ReEmployment  
Should Implement Additional Procedures To Ensure Subrecipient Findings Are  
Followed Up On In A Timely Manner (Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

*DTR will require the local areas to date-stamp their audit report to verify that the Department, then, received the audit report within thirty (30) days, or by March 31<sup>st</sup>, whichever is earlier. DTR will send another reminder letter to each LWIA individually on the anniversary date of receipt of their previous year's audit to again reiterate the submission requirements. To document that the LWIAs are in compliance with the submission date, DTR will compare the date on the audit report with the date the audit was received by DTR. Noncompliance with the submission requirements will result in an administrative finding being issued to the LWIA.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-CWD13-52: The Division Of Unemployment Insurance Should Ensure  
Federal Reports Are Supported By Accurate And Reliable Data**

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State Agency: Cabinet For Workforce Development

Federal Program: CFDA 17.225 – Unemployment Insurance

Federal Agency: U.S. Department of Labor

Pass-Through Agency: Not Applicable

Compliance Area: Reporting

Amount of Questioned Costs: None

The Employment and Training Administration (ETA) 581 form is inaccurately stated due to double adjustments made from noncompliance with UI procedures. UI is not complying with the established procedures to audit the processed payments before making adjustments. Tax data is entered from the employer quarterly reports. During the process of auditing these reports, UI will determine if the information posted to the accounting system is in error. The erroneous data will be deleted and the correct information entered. These transactions are not reflected in the accounts receivable activity report, which is the source document for the ETA 581. Auditing of reports is not being completed prior to the end of the quarter when the source document is generated. Thus, the accounts receivable activity report used as a source document for the ETA 581 is not a reliable indicator of actual receivables.

The information reported to the federal government on the ETA 581 was found to be inaccurate and unreliable. This information can affect ranking and funding for the state. The data is used in a quarterly publication called *State Performance Rankings* as performance indicators for national and regional office staff. This data is also used to evaluate whether or not states are meeting various tax performance measures and in the determination of workloads within each state for allocation of administrative funding from the USDOL to each state.

Proper internal controls dictate that accurate and reliable information be presented when preparing and transmitting federal reports. Reports should be adequately supported with valid and accurate documentation. All measures should be taken to ensure that the information being reported is as accurate as possible.

Per the USDOL, all states are required to implement a data validation (DV) program by July 31, 2003 that will validate reports that are submitted to the national office. This report, ETA 581, is one of the reports that this will validate. Based upon USDOL correspondence, this program will validate the accuracy of this report.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-CWD13-52: The Division Of Unemployment Insurance Should Ensure Federal Reports Are Supported By Accurate And Reliable Data (Continued)**

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**Recommendation**

We recommend that adequate controls be implemented to ensure erroneous or double adjustments are not made to employer accounts without there being an audit trail to follow. Audit activity needs to be performed to ensure the returns and adjustments are audited within a reasonable time to help eliminate the double adjustments and erroneous data.

We recommend the DV program be completed on time to be in compliance with USDOL initiatives.

**Management's Response and Corrective Action Plan**

*We agree with the finding that mainframe tax accounting source documents do not provide an accurate reconciliation of accounts receivable data for federal reporting purposes. We believe that the problem does not lie with the accounting system itself, but with the inability of the tax accounting staff to complete a timely audit of employer tax reports so that accurate data would exist on the mainframe as of the reporting date. The problem is further exacerbated by erroneous adjustments made by other tax staff based on unaudited accounting data. The cascade effect of errors compounding other errors has persisted now for several quarters, with the result that the mainframe accounting system is confounded with errors.*

*The simple explanation of how we arrived at this situation is the systemic neglect of staffing in the tax accounting section (and indeed throughout the tax branches) for many years. At its peak the tax branches (when they were a consolidated agency) employed 125 staff, with some 80 devoted to central office functions and approximately 20 in the accounting area alone. Today the entire UI tax program (field audit staff included) employs fewer staff than once worked in central office alone, and the accounting area is staffed with fewer than 10 full-time permanent state employees. Meanwhile our employer population, and the attendant accounting work, has increased.*

*Nor are staff numbers alone the source of the problem. Over the past five years we have lost nearly all of the long-term experienced staff in the tax program to retirement and other employment. The "institutional amnesia" resulting from the rapid depletion of our knowledge base has been severely damaging to our ability*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-CWD13-52: The Division Of Unemployment Insurance Should Ensure  
Federal Reports Are Supported By Accurate And Reliable Data (Continued)**

**Management's Response and Corrective Action Plan (Continued)**

*to maintain the work of the accounting area. When staff have been hired to replace those who have left, too often they have been temporary or interim workers who have not stayed long enough to acquire even a rudimentary understanding of the complexities of the tax accounting system and processes. Today there is no staff person in the tax accounting area who actually possesses professional accounting education or holds a title of graduate accountant. (Moreover, a previous UI Director did not deem it necessary that the supervisor over the accounting section should have an accounting background, a situation that persists!)*

*The impossibility of maintaining the workload in the tax accounting area with remaining staff has forced us to take extreme measures to reengineer the way in which we do business. These measures, taken in tandem, have been to employ radically different technology to perform the report auditing function; and to outsource the front-end processing of employer tax reports and payments to the Kentucky Revenue Cabinet. (We have also outsourced the entry of wage information to a private company when we were no longer allowed to use the services of Kentucky Correctional Industries to perform this task. The disruption resulting from this mandatory change put us even further behind.) Ultimately these changes will allow us to perform the tax accounting functions in a more efficient and cost-effective fashion. However, the process of the changes themselves have required considerable time (our reengineering project - KEWES - has been underway since July 1999) and engender more delays as staff learn to do business in new ways. Also, the reliance on business partners such as Revenue and the Governor's Office for Technology to perform more and more of the work we once performed ourselves means that we cannot control the entire process and must negotiate for priorities among competing responsibilities of those partner agencies.*

*Having reviewed the problems that put us where we are today, the solution is straightforward. We have established new processes and implemented new technology to gain all the efficiency possible. We will continue to work with the Revenue Cabinet to ensure that they provide the most timely processing of reports as possible, because until their work is done we cannot begin ours. We will continue to work with GOT and with our KEWES technology business partners to*

COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-CWD13-52: The Division Of Unemployment Insurance Should Ensure Federal Reports Are Supported By Accurate And Reliable Data (Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

*ensure that the information technology systems and network upon which are dependent are as reliable as the state of the art will allow. We will implement barriers in the tax accounting system to reduce the potential for erroneous adjustments by limiting access to unaudited data. However, after all these actions have been taken, we still require the staff to get the work done. The tax accounting area must be staffed not only with an adequate number of workers to complete their tasks on time, but those staff need to be appropriately educated and classified and permanent so that the investment in their training is not continually lost. The accounting area must be effectively managed by supervisors who thoroughly understand both the processes under their direction and the necessity of completing those processes on time. The upper management of DES must be responsive to the need to commit additional resources to this area when required to get the job done.*

*Once this occurs - and we are committed to seeing that it does – the information committed to the mainframe tax accounting system will at last be reliable, and accounts receivable data can be reconciled again for federal reporting. We will review the historical accounting records for errors remaining from the years in which this has not been the case. This cannot happen overnight. But it will happen.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-CWD14-53: The Division Of Unemployment Insurance Should Implement Procedures To Ensure The Accuracy And Timeliness Of The IRS 940 Federal Unemployment Tax Administration Certification**

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State Agency: Cabinet For Workforce Development

Federal Program: CFDA 17.225 – Unemployment Insurance

Federal Agency: U.S. Department of Labor

Pass-Through Agency: Not Applicable

Compliance Area: Special Tests and Provisions

Amount of Questioned Costs: None

During the audit of the Internal Revenue Service (IRS) 940 Federal Unemployment Tax Administration (FUTA) Match/Certification, we discovered that the date on the transmittal sheet was approximately seven (7) months past the due date. In FY 01, we were unable to do any testing on the 1999 FUTA Certification, as it was not transmitted until July 31, 2002. For the FY 02 audit, the certification was due on January 31, 2002, and it was not transmitted to the federal government until August 9, 2002. The IRS is not able to provide information to UI until September or November of the following year. Therefore, for FY 02, the 2000 certification should be performed at that time and submitted back to the IRS by January of the following year. The reason for UI's late submission was due to problems with reconciling the trial balance. This has been an issue in previous audits and continues to be a problem. UI has trouble getting the trial balance to reconcile to agency ledgers due to continual adjustments to employer accounts.

In addition, review of the supporting documentation showed that the trial balance amounts of taxable payroll were off by approximately \$16 million from the certification report. UI was unable to provide the auditors with the reason for this discrepancy, other than the knowledge that employer's taxable payroll amount exceeded the character width of the program. UI knew about the character width issue, but never corrected it due to the cost and inconvenience to adjust the program's character width.

An untimely report submission can affect the taxpayer's ability to take advantage of the FUTA tax credit. Also, not reporting timely can have an adverse reaction because of delays in taxpayers receiving notices of proposed tax increases/decreases, any refunds for decreases, or tax bills.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 02-CWD14-53: The Division Of Unemployment Insurance Should Implement Procedures To Ensure The Accuracy And Timeliness Of The IRS 940 Federal Unemployment Tax Administration Certification (Continued)**

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An inaccurate presentation of information from the certification run does not show the actual differences between UI's trial balance and the federal government's report. The 2000 certification spreadsheet does not present an accurate picture of the information UI received. Presenting inaccurate information could affect the course of action the federal government takes.

The IRS Document 6581 outlines the deadlines for the preparation of this certification. The deadline for this report is January, and it states that it is critical that this be met. 26 CFR 31.3302(a)-3(a) requires the state to provide this annually.

Proper internal controls dictate that accurate and reliable information be presented when preparing and transmitting federal reports. Reports should be adequately supported with valid and accurate documentation. All measures should be taken to ensure the information being reported is as accurate as possible.

**Recommendation**

We recommend UI implement controls to ensure the annual IRS 940 FUTA certification is performed timely and accurately.

We also recommend UI work to get the character width corrected to prevent this error in the report. This correction helps to ensure UI's trial balance agrees to the federal government's data and accurately show where there are discrepancies with this information.

**Management's Response and Corrective Action Plan**

*The Agency agrees with the recommendation that the Federal Certification should be timely to avoid adverse reactions for employers. The trial balance total for taxable payroll was \$16 million more than the certification; therefore, the character width of the program is not an issue. GOT and the Division are currently working on identifying the discrepancy. After analyzing the discrepancy the Agency will put into place the necessary steps to help avoid future discrepancies.*

**SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS**

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2002**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions</u></b>					
<i>(1) Audit findings that have been fully corrected:</i>					
FY 01	01-AGR1-35	The Department Of Agriculture Should Ensure Subrecipients Meet OMB Circular A-133 Audit Requirements	10.550	0	Resolved during FY 02.
FY 01	01-CFC3-37	The Cabinet For Families And Children Should Present Accurate Notes To The Schedule Of Expenditures Of Federal Awards	All	0	Due to improvements, this finding is downgraded to an other matter for FY 02. This finding is no longer required to be reported under <i>Government Auditing Standards</i> .
FY 01	01-CFC5-39	The Cabinet For Families And Children Should Comply with OMB Circular A-133 Compliance Supplement Appendix VII SAS 70 Examination Requirements	NA	0	Resolved during FY 02.
FY 01	01-CFC6-40	The Division Of Child Care Should Have Formalized Logical Security Procedures To Follow For The Kentucky Child Care Management System	NA	0	Resolved during FY 02.
FY 01	01-CFC7-41	The Cabinet For Families And Children Should Ensure Every Effort Is Made To Establish And Enforce Medical Support Obligations	93.563	0	Due to improvements, this finding is downgraded to an other matter for FY 02. This finding is no longer required to be reported under <i>Government Auditing Standards</i> .
FY 00	00-CFC-16	The Cabinet For Families And Children Should Establish And Enforce Medical Support Obligations For Custodial Parents	93.563	0	Due to improvements, this finding is downgraded to an other matter for FY 02. This finding is no longer required to be reported under <i>Government Auditing Standards</i> .

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions (Continued)</u></b>					
<i>(1) Audit findings that have been fully corrected (Continued):</i>					
FY 98	98-CFC-31	The Division Of Child Care Should Consistently Follow Logical Security Procedures For The Kentucky Child Care Management System	NA	0	Resolved during FY 02.
FY 01	01-FAC1-2	The Office Of Financial Management Should Improve Daily Monitoring Of The Sweep Amounts	NA	0	Resolved during FY 02.
FY 01	01-FAC4-5	The Office Of Financial Management Should Improve Security Of Its Servers	NA	0	Resolved during FY 02.
FY 01	01-FAC5-6	Catalog Of Federal Domestic Assistance Numbers Were Improperly Coded In MARS	NA	0	Due to improvements, this finding is downgraded to an other matter for FY 02. This finding is no longer required to be reported under <i>Government Auditing Standards</i> .
FY 01	01-CHS2-11	The Department For Public Health Should Complete A Formal Information System Security Policy	NA	0	Resolved during FY 02.
FY 01	01-CHS3-12	The Financial Management And Reporting Branch Should Limit Access To Deposits	NA	0	Resolved during FY 02.
FY 01	01-CHS5-14	The Vital Statistics Branch Should Perform An Accurate Cash Reconciliation	NA	0	Resolved during FY 02.
FY 01	01-CHS10-43	The Cabinet For Health Services Should Reconcile The Supplementary Medical Insurance Data To The Agency Level Unisys Reports	93.778	0	Due to improvements, this finding is downgraded to an other matter for FY 02. This finding is no longer required to be reported under <i>Government Auditing Standards</i> .

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions (Continued)</u></b>					
<i>(1) Audit findings that have been fully corrected (Continued):</i>					
FY 01	01-CHS11-44	The Division Of Substance Abuse Progress Reports For Subrecipient Monitoring Should Be Submitted In A Timely Manner	93.959	0	Resolved during FY 02.
FY 01	01-CHS12-45	The Cabinet For Health Services Should Have A System In Place To Identify Suspended Or Debarred Vendors	All	0	Resolved during FY 02.
FY 00	00-CHS-19	The Division of Substance Abuse Should Establish Procedures To Monitor Progress Reports	93.959	0	Resolved during FY 02.
FY 00	00-CHS-22	The Cabinet For Health Services Should Develop Procedures To Ensure Vendors Providing Services To Federal Programs Are Not Debarred Or Suspended By The Federal Government	All	0	Resolved during FY 02.
FY 97	97-CHS-47	The Finance And Administration Cabinet And The Cabinet For Health Service Should Develop Procedures To Ensure Vendors Providing Services To Federal Programs Are Not Debarred Or Suspended By The Federal Government	All	0	Resolved during FY 02.
FY 97	97-CHS-49	The Department For Public Health Should Develop A Complete Information System Security Policy	NA	0	Resolved during FY 02.
FY 01	01-LAB4-16	The Labor Cabinet's Division Of Administration Should Ensure Assets Are Safeguarded Within The Special Fund	NA	0	Resolved during FY 02.
FY 01	01-CPE1-47	The Council On Postsecondary Education Should Establish A Tickler System To Ensure Timely Completion Of The Council's Obligations	84.281	0	Resolved during FY 02.

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions (Continued)</u></b>					
<i>(1) Audit findings that have been fully corrected (Continued):</i>					
FY 01	01-KST1-20	The Department Of Treasury Should Notify The Office Of Financial Management In Writing Prior To Applying Multiple Approvals	NA	0	Resolved during FY 02.
FY 01	01-TC1-49	The Transportation Cabinet Should Strengthen Controls To Ensure Accurate Reporting On The Schedule Of Expenditures Of Federal Awards	NA	0	Resolved during FY 02.
FY 01	01-CWD1-21	The Division Of Unemployment Insurance Did Not Report Deferred Revenues	NA	0	Resolved during FY 02.
FY 01	01-CWD7-50	The Department For Training And ReEmployment Did Not Reconcile Financial Status Reports To MARS	17.255	0	Resolved during FY 02.
FY 01	01-CWD8-51	The Department For Training And ReEmployment Did Not Reconcile Subrecipient Reports	17.255	0	Resolved during FY 02.
FY 01	01-CWD9-52	The Department For Training And ReEmployment Did Not Monitor Timesheets To Ensure The Correct Project Code Was Being Charged	17.255	0	Resolved during FY 02.
FY 01	01-CWD12-55	The Department For Training And ReEmployment Did Not Correctly Report Some Amounts For JTPA Closeout	17.250	0	Resolved during FY 02.
FY 00	00-CWD-23	The Department For Training And ReEmployment Should Comply With JTPA Regulations And OMB Circular A-133 Regarding Resolution Of Subrecipient Audit Findings	17.246 17.250	0	Resolved during FY 02.
FY 00	00-CWD-25	The Department For Training And ReEmployment Should Complete The Process Of Reviewing Subrecipient Invoices And Updating MARS To Accurately Reflect Actual WIA Expenditures	17.255	0	Resolved during FY 02.

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions (Continued)</u></b>					
<i>(1) Audit findings that have been fully corrected (Continued):</i>					
FY 99	99-CWD-40	The Department Of Employment Services Should Implement Controls	17.246	\$613,950	Resolved during FY 02. USDOL dismissed the questioned costs.
FY 02		To Ensure All Applicable Regulations And Program Policies Are Followed In Their Administration Of Federal Programs		(613,950)	
Total Questioned Costs				<u>0</u>	
<i>(2) Audit findings not corrected or partially corrected:</i>					
FY 01	01-CFC1-1	The Cabinet For Families And Children Should Improve Local Area Network Server Security And Consistently Apply Policies To All Servers	NA	0	Specific issues improved from the prior year, but additional occurrences were identified for certain servers so the same general issues existed. These issues were identified in six (6) new findings for FY 02. Two (2) of these findings are reportable conditions.  See 02-CFC1-2 and 02-CFC2-3.
FY 01	01-CFC2-36	The Cabinet For Families And Children Should Maintain And Produce Records To Adequately Support Expenditures	93.558	0	FY 02 testing revealed missing case files and documentation. CFC has made significant improvement, but weaknesses still exist.  See 02-CFC15-35.
FY 01	01-CFC4-38	The Cabinet For Families And Children Should Develop A Policies And Procedures Manual To Ensure Subrecipient Monitoring Is Properly Performed	17.253 93.558 93.563 93.568 93.575 93.596	0	CFC has made progress toward complying with audit recommendations; however, exceptions were still noted.  See 02-CFC12-33.

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions (Continued)</u></b>					
<i>(2) Audit findings not corrected or partially corrected (Continued):</i>					
FY 00	00-CFC-12	The Cabinet For Families And Children Should Impose Sanctions On Subrecipients Who Fail To Meet Audit Requirements Set Forth By OMB Circular A-133	93.558 93.563 93.575 93.596	0	CFC has made progress toward complying with audit recommendations; however, exceptions were still noted.  See 02-CFC12-33.
FY 98	98-CFC-27	The Cabinet For Families And Children Should Maintain Records To Support Payments To Participants In The Kentucky Works Program	93.558	\$0	FY 02 testing revealed missing case files and documentation. CFC has made significant improvement, but weaknesses still exist. Questioned Costs were resolved in FY 01.  See 02-CFC15-35.
FY 97				777	
FY 01				(777)	
Total Questioned Costs				<u>\$0</u>	
FY 01	01-FAC2-3	The Finance And Administration Cabinet Should Improve Controls Over Preparation Of The Cash And Investment Note	NA	0	The cash and investment note preparation process has improved, but improvements are still needed in the classification and categorization areas.  See 02-FAC2-5.
FY 01	01-FAC3-4	The Office Of Financial Management Should Improve Control Procedures Over Modifications To System Programs	NA	0	Major processing programs were rewritten in the audit period by a new programmer on staff. However, the issue still remains.  See 02-FAC3-6.

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions (Continued)</u></b>					
<i>(2) Audit findings not corrected or partially corrected (Continued):</i>					
FY 01	01-FAC6-7	The Office Of Technical Services Should Improve Security Of The Servers Within The Local Area Networks For Finance And Administration Cabinet	NA	0	Enterprise security improved but agency level security is still weak. Additional issues were identified in six (6) new findings during testing of FAC servers for FY 02. Three (3) of these findings are reportable conditions.  See 02-FAC7-10, 02-FAC8-11, and 02-FAC9-12.
FY 01	01-FAC7-8	The Finance And Administration Cabinet Should Implement Policies And Procedures To Ensure Compliance With Applicable Small Or Small Minority Business Set-Aside Laws	NA	0	The Disparity Study was received by FAC in March 2003.  See 02-FAC1-4.
FY 00	00-FAC-6	The Office Of Financial Management Should Improve Control Procedures Over Modifications To System Programs	NA	0	See 02-FAC3-6.
FY 99	99-FAC-13	The Finance And Administration Cabinet Should Implement Policies And Procedures Relating To Small Or Small Minority Business Set-Aside Laws	NA	0	See 02-FAC1-4.
FY 01	01-CHS4-13	The Vital Statistics Branch Should Improve Security Over Assets And Segregate Job Duties	NA	0	Although progress has been made, there are still areas that need improvement.  See 02-CHS2-14.
FY 01	01-CHS6-15	The Vital Statistics Branch Should Take Steps To Prevent Identity Theft	NA	0	CHS will seek legislation again.  See 02-CHS3-15.

**COMMONWEALTH OF KENTUCKY**  
**SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS**  
**FOR THE YEAR ENDED JUNE 30, 2002**  
**(CONTINUED)**

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
<b><u>Reportable Conditions (Continued)</u></b>					
<i>(2) Audit findings not corrected or partially corrected (Continued):</i>					
FY 01	01-CHS9-42	The Drug Rebate Program Should Be More Involved In The Dispute Resolution Program In Order To Collect More Money	93.778	0	There continues to be a large amount of Drug Rebate accounts receivable outstanding.  See 02-CHS12-36.
FY 00	00-CHS-18	The Department For Medicaid Services Should Improve Claims Processing, Including The Dispute-Resolution Process With Drug Rebate Manufacturers	93.778	0	See 02-CHS12-36.
FY 99	99-CHS-36	The Department For Medicaid Services Should Improve The Controls Over Drug Rebate Billings, Collections, And Recording	93.778	0	See 02-CHS12-36.
FY 01	01-MIL1-46	The Department Of Military Affairs Should Ensure Subrecipients Meet OMB Circular A-133 Audit Requirements	83.544	0	The audit once again found that the Department of Military Affairs has not made improvements in their tracking system of audit reports.  See 02-MIL1-43.
FY 97	97-Military Affairs-50	The Department Of Military Affairs Should Strengthen Procedures For Monitoring Subrecipients	83.544	\$62,500	The questioned costs are resolved. However, the audit once again found that the Department of Military Affairs has not made improvements in their tracking system of audit reports.  See 02-MIL1-43.
FY 00				(34,747)	
FY 02				(27,753)	
Total Questioned Costs				<u>\$0</u>	

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions (Continued)</u></b>					
<i>(2) Audit findings not corrected or partially corrected (Continued):</i>					
FY 01	01-PERS1-17	The Personnel Cabinet Should Improve Security Controls For The Uniform Payroll And Personnel System Logical Access	NA	0	The agency has not complied with the corrective action proposed during the prior audit. Though programmers continue to access production JCL and data, we noted that new management is attempting to address this area of control and hired a security analyst to address such issues and work on improving controls.  See 02-PERS1-16.
FY 98	98-PERS-9	The Personnel Cabinet Should Implement Adequate Logical Access Security For The Unified Personnel And Payroll System	NA	0	See 02-PERS1-16.
FY 01	01-CPE2-48	The Council On Postsecondary Education Should Implement Additional Follow Up Procedures To Ensure That Required Information Is Requested If Not Received In A Timely Manner	84.281	0	The Council made improvements in this area; however, similar findings were noted during FY 02.  See 02-CPE1-44.
FY 01	01-REV1-18	The Revenue Cabinet Should Update The Sales Tax Database And Automate Processing Of Accelerated Tax Returns	NA	0	Revenue is working on automating accelerated tax returns, but it will likely not occur until FY 04.  See 02-REV2-18.

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions (Continued)</u></b>					
<b><i>(2) Audit findings not corrected or partially corrected (Continued):</i></b>					
FY 01	01-REV3-19	The Revenue Cabinet Should Have A System In Place To Reconcile Critical Information	NA	0	Revenue has a reconciliation project underway that is expected to begin in February 2003.  See 02-REV3-31.
FY 01	01-CWD2-22	The Division Of Unemployment Insurance Allowance For Uncollectible Accounts Was Not Updated For Current Year Actions	NA	0	See 02-CWD1-23.
FY 01	01-CWD3-23	The Cabinet For Workforce Development Should Improve Local Area Network Server Security And Consistently Apply Policies To All Servers	NA	0	Six new formal findings were issued for FY 02 regarding specific areas of LAN server security. Only one finding is a reportable condition.  See 02-CWD4-25.
FY 01	01-CWD10-53	The Division Of Unemployment Insurance Is Not Reconciling Accounts Receivable To Ensure Federal Reports Are Accurate	17.225	0	See 02-CWD13-52.
FY 01	01-CWD11-54	The Division Of Unemployment Insurance Has Not Performed The 1999 Certification Of Employer Contributions	17.225	0	See 02-CWD14-53.

***(3) Corrective action taken is significantly different from corrective action previously reported:***

No findings for this section.

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions (Continued)</u></b>					
<i>(4) Audit finding is no longer valid or does not warrant further action:</i>					
FY01	01-GOT1-9	The Governor's Office For Technology Should Improve The Application Development Control Structure For The Client/Server Applications On The UNIX Or Windows NT Operating Systems	NA	0	Significant improvements have been made, but some issues are still unresolved. These issues have been reported in the GOT SAS 70 audit report, released under separate cover.
FY99	99-GOT-22	The Governor's Office For Technology Should Restrict Programmer Access To Production Libraries	NA	0	See 01-GOT1-9 above.
FY 01	01-CHS1-10	Custom Data Processing, Inc. Should Improve System Security Controls For Cabinet For Health Services Data	NA	0	These issues have been reported in the CDP SAS 70 audit report, released under separate cover.

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Material Weaknesses/Noncompliances</u></b>					
<i>(1) Audit findings that have been fully corrected:</i>					
FY 01	01-LAB1-24	The Labor Cabinet's Division Of Administration Should Apply The Accrual Basis Of Accounting To The Special Fund	NA	0	Resolved during FY 02.
FY 01	01-LAB2-25	The Labor Cabinet's Division Of Administration Should Bill Assessment Receivables In A Timely Manner For The Special Fund	NA	0	Resolved during FY 02.
FY 01	01-LAB3-26	The Labor Cabinet's Division Of Administration Should Improve The Assessments Receivable System Reports For The Special Fund	NA	0	Resolved during FY 02.
FY 01	01-CPE6-30	The Council On Postsecondary Education Should Ensure Annual Reports For The Postsecondary Equine Trust And Revolving Fund Are Received In A Timely Manner	NA	0	Resolved during FY 02.
FY 01	01-CPE7-31	The Council On Postsecondary Education Should Ensure Annual Reports For The Professional Education Preparation Program, Metroversity Consortium, And Telecommunication Consortium Are Received In A Timely Manner	NA	0	Resolved during FY 02.
FY 01	01-REV2-32	The Revenue Cabinet Should Substantially Improve All System Related Controls Surrounding The Modernized Front End System	NA	0	Resolved during FY 02.
FY 01	01-CWD4-33	The Division Of Unemployment Insurance Did Not Have A Reliable Trial Balance	NA	0	Resolved during FY 02.
FY 01	01-CWD5-34	The Division Of Unemployment Insurance Continues To Materially Misrepresent Its Corrective Action Plan To Provide A Trial Balance For Employer's Tax Collections	NA	0	Resolved during FY 02.

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Material Weaknesses/Noncompliances (Continued)</u></b>					
<i>(1) Audit findings that have been fully corrected (Continued):</i>					
FY 01	01-CWD13-56	The Department For Training And ReEmployment Did Not Follow Up On Subrecipient Findings In A Timely Manner	17.255	0	Resolved during FY 02.
FY 01	01-CWD14-57	The Department For Training And ReEmployment Has Not Fully Implemented Its Corrective Action Plan To Monitor Subrecipient Reports	17.255	0	Resolved during FY 02.
FY 00	00-CWD-11	The Division Of Unemployment Insurance Should Implement The Corrective Action Plan To Assure The Closing Package Schedule For Account Receivable Is Correct	NA	0	Resolved during FY 02.
FY 99	99-CWD-44	The Office Of Training And ReEmployment Should Comply With Job Training Partnership Act Regulations And OMB Circular A-133 Regarding Resolution Of Subrecipient Audit Findings	17.246 17.250	0	Resolved during FY 02.
<i>(2) Audit findings not corrected or partially corrected:</i>					
FY 01	01-CPE3-27	The Council On Postsecondary Education Should Investigate Alternatives To Address The Apparent Inconsistency Between The Current Council Guidelines And The Current Provisions Of KRS 164.7919(1)(c)	NA	0	The Council will request that the 2003 General Assembly revise the language in the appropriations bill authorizing the Endowment Match program. Accordingly, the matter will not be resolved until the 2003 General Assembly approves a budget.  See 02-CPE6-29.

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Material Weaknesses/Noncompliances (Continued)</u></b>					
<b><i>(2) Audit findings not corrected or partially corrected (Continued):</i></b>					
FY 01	01-CPE4-28	The Council On Postsecondary Education Should Revise The Guidelines Applicable To The Regional University Excellence Trust Fund To More Clearly Define The Amount Of Matching That Will Be Permitted In The Areas Of Arts And Humanities	NA	0	<p>The Council has determined that it will monitor the arts and humanities applications and approvals and if any exceed 20% of the total requests from an institution for funds over the past five years, staff will notify Council members prior to the approval of any additional arts and humanities projects for that institution.</p> <p>See 02-CPE7-30.</p>
FY 01	01-CPE5-29	The Council On Postsecondary Education Should Implement Additional Procedures To Ensure That The Required Information Is Requested If Not Received In A Timely Manner	NA	0	<p>This condition still existed at June 30, 2002 but has been resolved subsequent thereto. The Council has received the report from KDE and the sum of \$283,000 from prior years has been returned to the Council. Council staff has met with KDE finance officials and a tickler system has been implemented. The MOA will be reviewed and reporting deadlines may be revised.</p> <p>See 02-CPE5-28.</p>

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
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**Material Weaknesses/Noncompliances (Continued)**

***(2) Audit findings not corrected or partially corrected (Continued):***

FY 99	99-CWD-30	The Division of Unemployment Insurance Should Ensure Computer Accounting Systems Are Operating Effectively And Amounts Reported From Those Systems Can Be Supported	NA	0	The trial balance was not used as supporting documentation for the current year therefore this portion of the comment is resolved; however, the portion related to system inadequacies remains.  See 02-CWD2-32.
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***(3) Corrective action taken is significantly different from corrective action previously reported:***

No findings for this section.

***(4) Audit finding is no longer valid or does not warrant further action:***

No findings for this section.

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## **APPENDICES**

**COMMONWEALTH OF KENTUCKY  
APPENDIX 1  
FOR THE YEAR ENDED JUNE 30, 2002**

List Of State Organizations Audited As Part Of The  
Statewide Single Audit Of The Commonwealth

The list includes agencies receiving only financial statement audits used for preparing the Commonwealth's CAFR. CPA reports are available upon request to the respective audited agency.

**STATE ORGANIZATIONS AUDITED BY CERTIFIED PUBLIC ACCOUNTING  
FIRMS AND INCLUDED IN SSWAK:**

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Kentucky Access Program  
Kentucky Affordable Prepaid Tuition  
Bluegrass State Skills Corporation  
Kentucky Center for the Arts\*  
Eastern Kentucky Exposition Center Corporation  
Kentucky Economic Development Finance Authority  
Kentucky Educational Savings Plan Trust  
Kentucky Educational Television Authority  
Kentucky Higher Education Assistance Authority  
Kentucky Higher Education Student Loan Corporation  
Kentucky Horse Park  
Kentucky Housing Corporation  
Kentucky Infrastructure Authority  
Judicial Form Retirement System  
Kentucky Local Correctional Facilities Construction Authority  
Kentucky Lottery Corporation  
Office of the Petroleum Storage Tank Environmental Assurance Fund  
Council on Postsecondary Education  
Kentucky Public Employees' Deferred Compensation Authority  
Kentucky Retirement Systems  
Kentucky River Authority  
Kentucky State Fair Board  
Kentucky Teachers' Retirement Systems  
Transportation Cabinet (Financial Statements Only)  
Turnpike Authority of Kentucky  
Kentucky Worker's Compensation Funding Commission  
Kentucky Worker's Compensation Special Fund, Coal Workers' Pneumoconiosis Fund  
(functions of the Labor Cabinet), and Uninsured Employers' Fund (function of the  
Office of the Attorney General)

\*The audit reports on the basic financial statements and OMB Circular A-133 for the Kentucky Center for the Arts Corporation were not received by March 17, 2003.

**COMMONWEALTH OF KENTUCKY  
APPENDIX 1  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

List Of State Organizations Audited As Part Of The Statewide Single Audit Of The Commonwealth (Continued)

**STATE ORGANIZATIONS AUDITED BY CERTIFIED PUBLIC ACCOUNTING FIRMS AND NOT INCLUDED IN SSWAK, EXCEPT FOR EXPENDITURE AMOUNTS IN THE OPINION LETTER:**

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Eastern Kentucky University  
Kentucky Community Technical College System  
Kentucky State University  
Morehead State University  
Murray State University  
Northern Kentucky University  
University of Kentucky  
University of Louisville\*  
Western Kentucky University\*\*

\*The University of Louisville's expenditures are not included in the opinion letter because the OMB Circular A-133 audit report was not complete as of March 17, 2003.

\*\*Western Kentucky University's audit report on the basic financial statements was not available at December 20, 2002; however, the OMB Circular A-133 audit report was available at March 17, 2003.

**STATE ORGANIZATIONS AUDITED BY THE AUDITOR OF PUBLIC ACCOUNTS:**

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Department of Agriculture  
Department of Education (Financial Statement Only)  
Cabinet for Families and Children  
Finance and Administration Cabinet  
Cabinet for Health Services  
Justice Cabinet (Federal Awards Only)  
Department of Military Affairs (Federal Awards Only)  
Personnel Cabinet – Risk Management Funds  
Kentucky Revenue Cabinet  
Transportation Cabinet (Federal Awards Only)  
Office of the Kentucky State Treasurer - Cash Functions  
Department of Parks (Financial Statement Only)  
Cabinet for Workforce Development

**COMMONWEALTH OF KENTUCKY  
APPENDIX 1  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

List Of State Organizations Audited As Part Of The Statewide Single Audit Of The Commonwealth (Continued)

**OTHER REPORTS USED BY THE AUDITOR OF PUBLIC ACCOUNTS:**

Custom Data Processing, Inc. SAS 70 Audit Report  
eFunds Corporation SAS 70 Audit Report  
Governor's Office For Technology SAS 70 Audit Report  
State Street Corporation SAS 70 Audit Report  
Unisys SAS 70 Audit Report  
Worker's Self-Insured Compensation Trust Fund Review Report

**COMMONWEALTH OF KENTUCKY  
APPENDIX 2  
FOR THE YEAR ENDED JUNE 30, 2002**

List Of State Organization Contacts

If additional copies of the statewide single audit are required, please contact Greg Giesler, Open Records Administrator, with the APA's office at (502) 573-0050 or [ggiesler@kyauditor.net](mailto:ggiesler@kyauditor.net). If copies of the CAFR for the FY 02 are required, please contact Gordon C. Duke, Finance and Administration Cabinet Secretary, at (502) 564-4240.

The following is a list of individuals by state organizations to contact regarding findings in the Schedule of Findings and Questioned Costs or the Summary Schedule of Prior Audit Findings.

<b>State Organization</b>	<b>Contact</b>
Kentucky Access Program	Frederick Nelson, JD, Director Division of Kentucky Access Department of Insurance P.O. Box 1380 Frankfort, KY 40602-1380 Phone: (502) 573-1026
Cabinet for Families and Children	Kelli Hill, Manager Division of Financial Management Cabinet for Families and Children 275 East Main Street 4C-C Frankfort, KY 40601 Phone (502) 564-2250 ext. 4336
Finance and Administration Cabinet	Stuart Weatherford, Director Division of Statewide Accounting Services Finance and Administration Cabinet Capitol Annex, Room 484 702 Capitol Avenue Frankfort, KY 40601 Phone (502) 564-7750  Ed Ross, Controller Office of the Controller Finance and Administration Cabinet Capitol Annex, Room 393 702 Capitol Avenue Frankfort, KY 40601 Phone (502) 564-2210

**COMMONWEALTH OF KENTUCKY  
APPENDIX 2  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

List Of State Organization Contacts (Continued)

<b>State Organization</b>	<b>Contact</b>
Finance and Administration Cabinet (Continued)	Don Speer, Commissioner Department of Administration Finance and Administration Cabinet 702 Capitol Avenue, Room 362 Frankfort, KY 40601 Phone (502) 564-2317
	George Burgess, Executive Director Office of Financial Management Finance and Administration Cabinet Capitol Annex, Room 261 702 Capitol Avenue Frankfort, KY 40601 Phone (502) 564-2924
Governor's Office for Technology	Steve Dooley, Executive Director Office of Administrative Services Governor's Office for Technology 1025 Capital Center Drive, Suite 101 Frankfort, KY 40601 Phone (502) 564-7777
Cabinet for Health Services	Miles Murphy, Staff Assistant Office of Program Support Cabinet for Health Services 275 East Main Street Frankfort, KY 40601 Phone (502) 564-8890
Justice Cabinet-Office of the Secretary	Charlotte Ellis, Branch Manager Division of Grants Management Justice Cabinet 403 Wapping St Frankfort, KY 40601 Phone (502) 564-3251

**COMMONWEALTH OF KENTUCKY  
APPENDIX 2  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

List Of State Organization Contacts (Continued)

<b>State Organization</b>	<b>Contact</b>
Labor Cabinet	Robert L. Whittaker, Director Division of Workers' Compensation Funds, Kentucky Labor Cabinet 1047 U.S. Highway 127 South, Suite 4 Frankfort, KY 40601-4381 Phone (502) 564-3070 ext. 391
Department of Military Affairs	Darlene Tufts, Fiscal Manager Division of Administrative Services Department of Military Affairs Boone National Guard Center 100 Minuteman Parkway, EOC Building Frankfort, KY 40601 Phone (502) 607-1514
Personnel Cabinet	Herb Sheeting, Commissioner Department of Personnel Administration Personnel Cabinet 200 Fair Oaks Lane Frankfort, KY 40601 Phone (502) 564-2428
Council on Postsecondary Education	Diann Donaldson Associate-Administrative Services Council on Postsecondary Education 1024 Capital Center Drive, Suite 320 Frankfort, KY 40601 Phone (502) 573-1555
Revenue Cabinet	Annie Hill-Pointer, Internal Auditor Office of the Secretary Kentucky Revenue Cabinet 200 Fair Oaks Lane Frankfort, KY 40601 Phone (502) 564-1553

**COMMONWEALTH OF KENTUCKY  
APPENDIX 2  
FOR THE YEAR ENDED JUNE 30, 2002  
(CONTINUED)**

List Of State Organization Contacts (Continued)

<b>State Organization</b>	<b>Contact</b>
Transportation Cabinet	Taylor Manley, Commissioner Department of Fiscal Management Transportation Cabinet State Office Building, 10th Floor Frankfort, KY 40601 Phone (502) 564-4786
Office of the Kentucky State Treasurer	Dr. Eugene Harrell, Director Disbursements Office of the Kentucky State Treasurer Capitol Annex, Room 183 702 Capitol Avenue Frankfort, KY 40601 Phone (502) 564-4722
Cabinet for Workforce Development	Tommy Goins, Branch Manager Division of Fiscal Services Cabinet of Workforce Development 500 Mero Street 9th Floor Frankfort, KY 40601 Phone (502) 564-3200